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Dear Janie

ASB Consultation Paper 'IASB Proposals on Business Combinations, Impairment and Intangible Assets'

The Federation is pleased to have the opportunity to comment on the Consultation Paper 'IASB Proposals on Business Combinations, Impairment and Intangible Assets'.

The Federation represents nearly 1400 independent, not for profit housing providers. Our members include registered social landlords, housing associations, co-ops, trusts and transfer organisations. They manage more than 1.8 million homes provided for affordable rent, supported housing and low cost home ownership as well as delivering a wide range of community and regeneration services.

Housing associations have historically been actively involved in business combinations where it is not possible to identify one participant as an acquirer. I am therefore attaching a detailed document responding to the relevant questions within the Consultation Paper. However, in particular, the Federation:

- supports the retention of the provisions within FRS 6 which defines a group reconstruction and permits merger accounting to be used for such transactions under certain conditions;
- considers that an appropriate level of materiality should be involved above which compliance is mandatory to avoid unnecessary expense for reporting immaterial levels of transactions; and



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Independent, not-for-profit social landlords provide more than 1.8 million homes in England. The Federation is their voice and an advocate of decent housing for all.

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- agrees that with the ASB consultation approach to replace relevant UK standards concerned with business combinations, intangible assets and impairment only once both Phase I and Phase II of the IASB's project are complete.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Janine Relph', written over a circular stamp or seal.

Janine Relph
Policy Officer

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NATIONAL HOUSING FEDERATION

Response to ASB Consultation Paper 'IASB Proposals on Business Combinations, Impairment and Intangible Assets

ED3 Business Combinations

Question 1 - Scope

(a) Are these scope exclusions appropriate? If not, why not?

No. FRS 6 defines a group reconstruction and permits merger accounting ('pooling of interests' method) to be used for such transactions provided certain criteria are met. The IASB's decision to postpone addressing the requirements for entities under common control will mean that, if the ASB adopted the proposals and withdrew FRS 6 we would be left with no guidance on how to account for these particular types of group reconstruction.

For the reasons outlined below, we strongly believe there are classes of transactions whereby the 'pooling of interests' method appropriately reflects the true substance of that transaction. The Federation looks forward to contributing to the consideration of the definition and criteria that should apply to true merger transactions in the IASB's second phase of this project. However, in the interim, support the retention of the provisions within FRS 6 permitting merger accounting as interpreted within the *Statement of recommended practice: accounting for registered social landlords Update 2002 SORP* (paragraphs 13 1-132).

Question 2 - Method of accounting for business combinations

Is this appropriate? If not, why not? If you believe the pooling of interests method should be applied to a particular class of transactions, what criteria should be used to distinguish those transactions from other business combinations, and why?

Not in all cases. The purchase method is recognised to be appropriate where a business combination results in one entity obtaining control of another entity (or entities) and that an acquirer can be identified in the process. However, this is not

always the case. Historically, many housing associations have combined with the purpose of sharing in the future risks and benefits of the combined entity as opposed to one party acquiring control of another. As provided in FRS 6, for such mergers it is misleading to account for the combinations as the application of resources by one party to obtain control over the other, since this assumes a distinction in the roles of the parties that does not reflect reality (paragraph 48). Furthermore, the joint history of the entities that have combined will be relevant to the combined group's shareholders. This record will be provided by merger accounting because it treats the separate business as though they were continuing as before, only now jointly owned and managed. If acquisition accounting were to be used, it would focus artificially on only of the parties to the combination, which would lead to a discontinuity in information reported on the combined entity (paragraph 49).

The Federation supports the criteria for distinguishing a true merger from other business combinations in FRS 6 as interpreted in the SORP. The five necessary criterion required within FRS 6 is applied by the SORP to the not-for-profit, non-distributing activities of housing associations in paragraphs 131-132 as follows:

The SORP provides that merger accounting following the combination of two social landlords is restricted to, and required for, those combinations where the use of acquisition accounting would not properly reflect the true nature of the combination. In a merger, the parties come together to share in the future risks and benefits of the combined entity, rather than one party acquiring control of another. A combination meets the definition of a merger only if it satisfies the criteria set out in paragraphs 6 to 11 of FRS 6 as interpreted in the following paragraphs in the case of a combination of two social landlords.

Where criteria 1 and 2 of FRS 6 are met and where the additional criteria, interpreted as follows, are also met then the combination may be interpreted as a merger under FRS 6:

- (a) the relative sizes of the combining parties are not so disparate that one party dominates the combined entity by virtue of its relative size. This may not be

applicable if it can be clearly shown that the strategy in the direction of the combined organisation is not dominated by the larger party (criterion 3);

- (b) no consideration passes as a result of the combination (replacing criteria 4 and 5 under FRS 6 which are not applicable to non-profit distributing entities); and
- (c) the combination is expressly for the mutual benefit of the tenants of both social landlords.

The basis for asserting that true mergers exist and that the ‘pooling of interests’ method is the appropriate accounting treatment for such transactions is well established by considering both the fundamental characteristics of mergers within the housing association sector and the principle objectives underlying the proposed guidance on business combinations.

- **Fundamental principles**

The principles underlying FRS 6 and ED 3 is not relevant to not-for-profit non-surplus distributing organisations as both these documents are trying to reflect the commercial effect of the business combination transaction fairly in the accounts. That is, they are concerned with the relative control of the combining organisations in the new entity so that it can determine how the combination of resources should be shown so as to be fair to both sets of shareholders.

- **Housing association’s rationale for combining**

The mission statements of most housing associations will say something to the effect that they exist to provide homes for those in housing need, to meet the housing needs of current and future tenants.

Therefore, any combination of housing associations always has protection of tenants’ housing interests as their ultimate objective. Housing associations are not looking to generate profits. If any surplus were generated by a combination this could not be distributed but would be ploughed back into the housing association for provision of more and/or cheaper housing for rent.

- **Types of housing association combinations**

To date many housing association combinations have been at the request of the Housing Corporation, usually to rescue a smaller housing association in financial difficulty. No consideration is given for the takeover. As members of housing associations a non-stake holding no payment is made to the members of the housing association being combined. The larger housing association is obliged to take on smaller housing associations using the strength of its own asset base and income streams. In some cases there may be income deficiency but asset strength.

Other combinations have been by mutual agreement of the two housing associations, because they could be more efficient in the management of homes or more productive in their development as a combined organisation.

In the future, with more pressure on housing associations from government to provide value for money in the management and development of homes for rent it may be that housing associations are more active in seeking combination opportunities. However, this would only take place because it was for the ultimate benefit of the combining housing associations' tenants.

- **Commerciality**

The housing association combination is not normally a commercial one and is not at arms length.

Although most housing association combinations could be regarded as an acquisition by the larger association, it is not primarily for the benefit of the members of that association (as they are not stake holding members), but for the benefit of the tenants of the smaller associations. If the smaller association was in financial difficulty its tenants might otherwise lose their homes.

- **Consideration**

Housing association combinations are normally for nil consideration with no goodwill. The lack of consideration means that there is no purchase consideration to

allocate and no excess or deficit of consideration to consider. This situation has been acknowledged within the *Statement of Principles for Financial Reporting: Proposed Application Note for Public Benefit Entities* (dated 28 February 2003) with a footnote stating that ‘an alternative view is that because of the lack of consideration and the need to preserve the history of the combining entities business combinations between public benefit entities should generally be treated as mergers’ (paragraph 8.13).

- **Consistency**

Most housing associations do not value housing property in their accounts as valuations are costly and do not add value for the users of the accounts.

The main exceptions to this are housing associations set up to take large scale transfers of local authority homes. Here valuations are needed as part of the transfer deal and to leverage private finance as no public grant is involved.

As housing properties are the most significant element of an association’s accounts, showing housing property obtained through combination at valuation would either create inconsistency in the accounts or force associations to revalue all their housing properties. This would be a costly exercise and would of no benefit to the members of the association.

- **Practical issues**

Housing associations do not have traditional stake holders who would benefit from the information provided by a valuation of assets transferred on acquisition. Property valuation is only an issue when finance needs to be raised against the property and then lenders instruct valuers for their own purposes.

The cost of valuation is a particular burden to smaller associations which is difficult to justify when there is no benefit to the users of the accounts.

Conclusion

Housing association combinations are not normally on a commercial basis and are for nil consideration. No payment is made to the members of the association being merged and no distribution is made of any surpluses generated. Therefore, acquisition accounting will not normally be appropriate and the 'pooling of interests' method should generally be applied to obtain a true and fair view of the substance of the transaction involved.

IAS 36 Impairment of Assets

Measuring value in use

The Federation is not convinced that the proposed narrative disclosures would prove more appropriate to that of the cash flow test required under FRS 11. We are concerned that the new tests may be overly onerous to apply particularly for smaller organisations and would prefer to continue using the current UK system of systematic year-by-year amortisation of goodwill.

It is also suggested that while measurement and calculation is involved, the title 'measuring value in use' is flawed as it implies spurious accuracy. The title 'estimating value in use' is proposed as a more suitable description.

IAS 38 Intangible Assets

Question 3 - Indefinite useful life

It does not seem prudent to give an asset an indefinite useful life. It could also be argued that to carry an intangible asset forward sine die suggests that the asset continues forever, when in reality it only exists at the point it was paid for. The value changes immediately thereafter. Furthermore, how can one determine whether the result from a fair value reappraisal of the asset relates to the old business or the new?

Question 4— Useful life of intangible

It is recommended that the circumstances where renewal periods are included within the useful life should include the probability of that renewal occurring in addition to any contractual or other legal rights conveyed.