

IPSASB Exposure Draft 48 *Separate Financial Statements*

AASB Staff Issues Paper

Introduction

- 1 The International Public Sector Accounting Standards Board (IPSASB) issued Exposure Draft (ED) 48 *Separate Financial Statements* (Agenda paper 12.2.1) in October 2013 and requested comments by 28 February 2014. This issues paper has been prepared by AASB staff with the intention of identifying any issues and comments that could be addressed in a submission to the IPSASB in respect of IPSAS ED 48.
- 2 The proposals in this ED (together with those in ED 49 *Consolidated Financial Statements*) are intended to update and replace IPSAS 6 *Consolidated and Separate Financial Statements*. ED 48 is based on IAS 27 *Separate Financial Statements* (as amended in 2011) and closely follows the requirements of that standard. The ED also incorporates *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27) issued by the IASB in October 2012. The objective of the ED is to propose the accounting and disclosure requirements for investments in controlled entities, joint ventures and associates when an entity prepares separate financial statements.
- 3 This ED proposes similar requirements to those currently in IPSAS 6 *Consolidated and Separate Financial Statements* for separate financial statements.
- 4 Aside from the terminology changes required for the public sector, the only difference noted between IAS 27 (as amended in 2011) and ED 48 is that ED 48 permits investments in controlled entities, joint ventures and associates to be accounted for in separate financial statements using the equity method, at cost or as financial instruments (as per the current requirement in IPSAS 6). IAS 27 does not currently permit the use of the equity method in separate financial statements. This issue is discussed below under Specific Matter for Comment 1.

Matters for Comment

Matter for Comment 1

Do you agree generally with the proposals for separate financial statements? In particular, do you agree with the proposal to permit the use of the equity method, in addition to cost or fair value, for investments in other entities?

AASB Staff Analysis

Use of the equity method

- 5 As mentioned in paragraph 4 above the proposals in ED 48 permit the use of the equity method for separate financial statements whereas IAS 27 does not. However, the IASB has proposed in ED/2013/10 *Equity Method in Separate Financial Statements* to allow entities to account for subsidiaries, joint ventures and associates to use the equity method in the separate financial statements. These IASB proposals have not yet been finalised.

6 At the December 2013 AASB meeting, the Board discussed the proposals in IASB ED/2013/10 and expressed concern that the proposals to allow entities to account for subsidiaries, joint ventures and associates using the equity method in separate financial statements could result in the IASB inappropriately setting a precedent of amending IFRSs to address specific local legislative requirements¹. The AASB noted that the issue of equity accounting is the subject of an IASB research project and recommends that any amendments to the application of the equity method be considered as part of this project.

7 Paragraph BC5 of ED 48 provides the IPSASB rationale for diverging from IAS 27 (as amended in 2011) and continuing to allow the use of the equity method in separate financial statements. This paragraph states:

The equity method is a well-established method of accounting for certain investments in the public sector. In many circumstances where investments are held by public sector entities, the equity method can provide information that is reliable and useful, and possibly at a lower cost than either the cost method or the fair value method. In the public sector, investments are often used more as “instruments” to enable service provision, rather than as a holding for investment purposes, as might generally be the case in the private sector. The equity method may therefore, in some circumstances, be better suited to meeting user needs in the public sector, as it allows the financial statements to portray the fluctuations in the equity of, and performance by, an investment over time, in a cost effective and easily understood manner.

Although application of the cost method is often relatively straightforward, where investments have been held for some time, using the cost method may result in outdated and less relevant information, in which case, it would not meet user needs.

In the public sector there are likely to be a higher proportion of investments for which there are no active markets and in respect of which fair values are not readily observable. Although the guidance in IPSAS 29 [*Financial Instruments*] can be used to derive a value for such investments, the IPSASB considered that this approach would generally result in information that did not faithfully represent the underlying circumstances.

8 Given the above rationale and the current option to use the equity method in IPSAS 6, AASB staff can generally accept the proposals in ED 48 to continue to allow the use of the equity method in separate financial statements.

1 When deciding to reconsider this issue the IASB acknowledged that corporate law in some countries requires that the equity method of accounting be used to measure certain investments when presenting separate financial statements.

Suggested revised wording

- 9 However, we suggest that the wording in paragraphs 7 and 16 of ED 48 be aligned to the wording in paragraphs 6 and 12 of IASB ED/2013/10² to avoid any confusion and unintended accounting outcomes that are not in line with the principles of the equity method as explained below.
- 10 Paragraph 7 of ED 48 states (emphasis added) *“Separate financial statements are those presented in addition to consolidated financial statements or in addition to financial statements in which investments in associates or joint ventures are accounted for using the equity method, other than in the circumstances set out in paragraphs 9-10³. Separate financial statements need not be appended to, or accompany, those statements.”*
- 11 If the proposals of ED 48 and ED 50 become a standard without any change to the definition above, it would cause confusion about identifying separate financial statements for an entity with associates and joint ventures but no subsidiaries. Consequently, an entity would use the equity method for associates and joint ventures in its financial statements prepared in accordance with ED 50 and could also use the equity method for such investments in separate financial statements.
- 12 To help avoid confusion, AASB staff suggest that the proposed definition of ‘separate financial statements’ be amended as per the definition in Paragraph 6 of IASB/2013/10 *“Separate financial statements are those presented in addition to consolidated financial statements or in addition to the financial statements of an entity that does not have investments in subsidiaries, ie investor in an associate or joint venture, other than in the circumstances set out in paragraph 8-8A⁴. Separate financial statements need not be appended to, or accompany those statements”*.
- 13 Paragraph 16 of ED 48 states: *“An entity shall recognize a dividend or similar distribution from a controlled entity, a joint venture or an associate in surplus or deficit in its separate financial statements when its right to receive the dividend or similar distribution is established.”*
- 14 Paragraph 16 of ED 48 requires the distribution to be recognised in surplus or deficit (directly) regardless of the method is used to account for subsidiaries, associates or joint ventures (equity method, cost or fair value). If the equity method is used to account for an investment, recognising the distribution in surplus or deficit directly would result in double counting as the entity would recognise its share of surplus or deficit of the investment (from which the dividend is distributed). As such, under the equity method, when a right to dividend is established, it would reduce the carrying amount of the investment and increase current receivables of the investor.
- 15 Based on the above, we suggest that Paragraph 16 of ED 48 be amended in line with Paragraph 12 of IASB/2013/10, which states: *[A] dividend from a subsidiary, a joint*

2 IASB ED/2013/10 closes for comment on 3 February 2014 and no date for the issue of an IFRS has been set.

3 Paragraphs 9-10 are the exemption from consolidation in ED 49 (IFRS 10 equivalent) or from applying the equity method in ED 50 (IAS 28 equivalent)

4 Paragraphs 8-8A are the exemption from consolidation in IFRS 20 or from applying the equity method in IAS 28

venture or an associate is recognised in the separate financial statements of an entity when the entity's right to receive the dividend is established. The dividend is recognised:

- (a) in profit or loss if the entity elects to measure the investment at cost or in accordance with IFRS 9; or*
- (b) as a reduction from the carrying amount of the investment if the entity elects to use the equity method.*

Question to the Board

- (a) Do Board members agree with the staff recommendation that the option for the equity method be retained for ED 48?
- (b) Do Board members agree with the staff recommendation that paragraphs 7 and 16 of ED 48 should be amended to align with paragraphs 6 and 12 of IASB ED/2013/10?