IPSASB Exposure Draft 49 *Consolidated Financial Statements*

AASB Staff Issues Paper

Introduction

1. The International Public Sector Accounting Standards Board (IPSASB) issued Exposure Draft (ED) 49 *Consolidated Financial Statements* (Agenda paper 12.3.1) 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 IPSASB ED 49.

2. The proposals in this ED (together with those in ED 48 *Separate Financial Statements*) are intended to update and replace IPSAS 6 *Consolidated and Separate Financial Statements*. ED 49 is based on IFRS 10 *Consolidated Financial Statements* and includes the amendments to that standard for *Investment Entities* which was issued in October 2012. The objective of the ED is to propose principles for the presentation and preparation of consolidated financial statements when a public sector entity controls one or more other entities.

3. One major change from IPSASB 6 is that IPSAS 6 gives an exemption from consolidation for temporarily controlled entities. This issue is discussed below under Specific Matter for Comment (SMC) 3.

4. Aside from the terminology changes and extra guidance required for the public sector the most significant difference between IFRS 10 and ED 49 is that ED 49 does not require that a controlling entity, that is not itself an investment entity to consolidate all its controlled entities. Instead it requires that such a controlling entity shall present consolidated financial statements in which it (i) measures the investments of the controlled investment entity at fair value through surplus or deficit in accordance with IPSAS 29 *Financial Instruments* and (ii) consolidates the other assets and liabilities and revenue and expenses of the controlled investment entity in accordance with ED 49. This issue is discussed below under SMC 5.

Specific Matter for Comment 1
Do you agree with the proposed definition of control? If not, how would you change the definition?

AASB Staff Analysis

5. ED 49 defines control as:

> An entity controls another entity when the entity is exposed, or has rights, to variable benefits from its involvement with the other entity and has the ability to affect the nature and amount of those benefits through its power over the entity.

Whilst the IFRS 10 definition of control of an investee is:

> An investor controls an investee when the investor is exposed or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

Therefore, the only main variance between the two definitions is the use of different terminology to suit the public sector entity rather that investor or investee and benefits rather than returns.

6. Although the AASB did not amend the IFRS definition for AASB 10 *Consolidated Financial Statements* AASB staff have no objections to the changes made for ED 49 and agree with the proposed definition of control.

Question 1 to the Board

Do Board members agree with the staff comments regarding SMC 1?

Specific Matter for Comment 2

Do you agree that a controlling entity should consolidate all controlled entities (except in the circumstances proposed in this Exposure Draft)? If you consider that certain categories of entities should not be consolidated, please justify your proposal having regard to user needs and indicate your preferred accounting treatment for any such controlled entities. If you have any comments about temporarily controlled entities, please respond to Specific Matter for Comment 3.

AASB Staff Analysis

7. AASB staff agree that all controlling entities should consolidate controlled entities except for controlling entities that are investment entities (see SMC 4 below). This is the requirement in IFRS 10 and we see no public sector specific reason for divergence.

Question 2 to the Board

Do Board members agree with the staff comments regarding SMC 2?

Specific Matter for Comment 3

Do you agree with the proposal to withdraw the exemption in IPSAS 6, *Consolidated and Separate Financial Statements* (December 2006) for temporarily controlled entities? If you agree with the withdrawal of the exemption please give reasons. If you disagree with the withdrawal of the exemption please indicate any modifications that you would propose to the exemption in IPSAS 6 (December 2006).

AASB Staff Analysis

8. As mentioned above in paragraph 3 above, IPSAS 6 required the consolidation of all controlled entities apart from controlled entities where there was evidence that (a) control was intended to be temporary because the controlled entity was held exclusively with a view to its disposal within twelve months from its acquisition and

(b) management was actively seeking a buyer. Such temporarily controlled entities were required to be accounted for as financial instruments.

9. The IPSASB noted that there was often difficulty in identifying temporarily controlled entities, difficulty in disposing of an investment in its current form and often the disposal could take several years in which case it was difficult to justify a different accounting treatment. In addition, a public sector entity holding such investments was still exposed to the risks of that investment and therefore they should be reported consistently with other controlled entities.

10. AASB staff note that one IPSASB member expressed an alternative view and felt that the exemption from consolidation for temporarily controlled entities should be retained – this alternative view can be found on page 63 of ED 49 (Agenda paper 12.3.1).

11. Although there is no equivalent to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* within IPSASs, AASB staff agree with the proposal to remove the exemption for consolidation for temporarily controlled entities for the reasons given by the IPSASB.

Question 3 to the Board

Do Board members agree with the staff comments regarding SMC 3?

Specific Matter for Comment 4

Do you agree that a controlling entity that meets the definition of an investment entity should be required to account for its investments at fair value through surplus or deficit?

AASB Staff Analysis

12. We can accept the exception from consolidation for investment entities on the basis that this is consistent with the requirements in IFRS10 and we do not consider that there is any specific public sector reason to have different accounting requirements. Therefore, AASB staff can accept this proposal.

Question 4 to the Board

Do Board members agree with the staff comments regarding SMC 4?

Specific Matter for Comment 5

Do you agree that a controlling entity, that is not itself an investment entity, but which controls an investment entity should be required to present consolidated financial statements in which it (i) measures the investments of the controlled investment entity at fair value through surplus or deficit in accordance with IPSAS 29, *Financial Instruments: Recognition and Measurement,* and (ii) consolidates the other assets and liabilities and revenue and expenses of the controlled investment entity in accordance with the Standard?

Do you agree that the proposed approach is appropriate and practicable? If not, what approach do you consider would be more appropriate and practicable?

AASB Staff Analysis

13. Whilst we can accept that an investment entity can be exempted from consolidation on the basis that it is consistent with IFRS 10 (see SMC 4) we do not agree with proposal that a controlling entity that is not an investment entity should measure a controlled investment entity's investments at fair value through surplus or deficit.

14. We support the IASB's arguments for requiring consolidation by the controlling entity as explained in the Basis for Conclusions of IFRS 10, particularly the arguments set out below:

> The IASB considered that the argument for a fair value measurement requirement is weakened at a non-investment entity level because these entities (i) have other substantial activities besides investing, and (ii) do not manage substantially all of their assets on a fair value basis. The IASB noted that permitting fair value measurement of investment entities in these situations would not be consistent with their decision to require that investment entities account for controlled entities at fair value because that decision was based on the unique business model of investment entities.
>
> The IASB had concerns that if a non-investment controlling entity were required to retain the fair value treatment used by its controlling entities, it could achieve different accounting outcomes by holding controlled entities directly or indirectly through a controlled investment entity. A non-investment controlling entity could reduce the level of information about highly leveraged activities or loss-making activities by placing those activities in controlled investment entities. This concern was magnified by the possibility that there could be a larger number of investment entities than the IASB had originally envisaged.

15. AASB staff also note the AASB response to IASB ED/2011/4 *Investment Entities* stated:

> The AASB considers that the parent of an investment entity that is not itself an investment entity should be required to consolidate all of its controlled entities including those it holds through subsidiaries that are investment entities.
>
> The AASB believes that this restriction is essential to help avoid structuring designed to achieve particular accounting outcomes.
>
> Furthermore, if the exception were to flow up into the consolidated financial statements of the parent, it would be inconsistent with the whole focus of ED/2011/4 on entities that meet the investment entity criteria. That is, the AASB can understand that the accounting for a particular type of transaction or item might flow up into higher levels

> of a group, but not when the accounting policy depends on the nature of the entity itself.

16. The IPSASB noted the IASB's arguments and considered whether there were any public sector characteristics that would support a differing accounting treatment by the controlling entity of an investment entity.

17. The Basis for Conclusions to ED 49 states:

> The IPSASB noted that the IASB had concerns that if a non-investment controlling entity were required to retain the fair value treatment used by its controlled investment entities, it could achieve different accounting outcomes by holding controlled entities directly or indirectly through a controlled investment entity. The IPSASB considered that this issue was of less concern in the public sector context. In particular, the IPSASB noted that ownership interests through shares or other equity instruments are less common in the public sector. As a consequence, it is less likely that entities within an economic entity in the public sector would hold an ownership investment in the ultimate controlling entity and less likely that they would have ownership investments in other entities within the economic entity.
>
> The IPSASB considered what type of information users would find most useful about a controlled investment entity. The IPSASB considered that users would find it most useful if the accounting for investments applied in a controlled investment entity's financial statements were extended to its controlling entity's financial statements. The IPSASB therefore proposed that a controlling entity with a controlled investment entity should be required to present consolidated financial statements in which it (i) measures the investments of the controlled investment entity at fair value through surplus or deficit in accordance with IPSAS 29 and (ii) consolidates the other assets and liabilities and revenue and expenses of the controlled investment entity in accordance with the usual consolidation accounting policies required by the Standard. The IPSASB considered that its proposals reflect the fact that a controlling entity does not manage an investment entity itself on a fair value basis. Rather, it manages the investments of the investment entity on a fair value basis. This approach is also consistent with the accounting by an investment entity for its investments in other entities.

18. Despite the IPSASB arguments, AASB staff do not support to extend the exemption from consolidation to controlling entities of investment entities which are not investment entities themselves, for the reasons stated above in paragraph 14.

Question 5 to the Board

Do Board members agree with the staff comments regarding SMC 5?

Specific Matter for Comment 6 The IPSASB has aligned the principles in this Standard with the Government Finance Statistics Manual 2013 (GFSM 2013) where feasible. Can you identify any further opportunities for alignment?

AASB Staff Analysis

AASB staff have not identified any further opportunities for alignment with the GFSM 2013.

Question 6 to the Board Do Board members agree with the staff comments regarding SMC 6?