

Exposure Draft

October 2013

Comments due: February 28, 2014

*Proposed International Public Sector Accounting
Standard*

Consolidated Financial Statements



International Public
Sector Accounting
Standards Board™

This Exposure Draft 49, *Consolidated Financial Statements*, was developed and approved by the International Public Sector Accounting Standards Board (IPSASB).

The IPSASB sets International Public Sector Accounting Standards (IPSASs) for use by public sector entities, including national, regional, and local governments, and related governmental agencies. A key part of the IPSASB's strategy is to converge the IPSASs, to the extent appropriate, with the IFRSs issued by the IASB.

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening transparency and accountability of public sector finances.

The structures and processes that support the operations of the IPSASB are facilitated by the International Federation of Accountants (IFAC).

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REQUEST FOR COMMENTS

This Exposure Draft 49, *Consolidated Financial Statements*, was developed and approved by the International Public Sector Accounting Standards Board (IPSASB).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by February 28, 2014.**

Respondents are asked to submit their comments electronically through the IPSASB website, using the "[Submit a Comment](#)" link. Please submit comments in both a PDF and Word file. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. Although IPSASB prefers that comments are submitted via its website, comments can also be sent to Stephenie Fox, IPSASB Technical Director at stepheniefox@ipsasb.org.

This publication may be downloaded free of charge from the IPSASB website: www.ipsasb.org. The approved text is published in the English language.

Objective of the Exposure Draft

The objective of this Exposure Draft is to propose principles for the presentation and preparation of consolidated financial statements when a public sector entity controls one or more other entities.

Guide for Respondents

The IPSASB would welcome comments on all of the matters discussed in this Exposure Draft. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

The Specific Matters for Comment requested for the Exposure Draft are provided below.

Specific Matter for Comment 1:

Do you agree with the proposed definition of control? If not, how would you change the definition?

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.

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).

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?

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 this 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?

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?

IPSAS XX (ED 49)—CONSOLIDATED FINANCIAL STATEMENTS

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<p>International Public Sector Standard XX (ED 49), <i>Consolidated Financial Statements</i>, is set out in paragraphs 1-79. All the paragraphs have equal authority. IPSAS XX (ED 49) should be read in the context of its objective, the Basis for Conclusions, and the <i>Preface to International Public Sector Accounting Standards</i>. IPSAS 3, <i>Accounting Policies, Changes in Accounting Estimates and Errors</i>, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.</p>

Objective

1. The objective of this Standard is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.
2. To meet the objective in paragraph 1, this Standard:
 - (a) Requires an entity (the controlling entity) that controls one or more other entities (controlled entities) to present consolidated financial statements;
 - (b) Defines the principle of control, and establishes control as the basis for consolidation;
 - (c) Sets out how to apply the principle of control to identify whether an entity controls another entity and therefore must consolidate that entity;
 - (d) Sets out the accounting requirements for the preparation of consolidated financial statements; and
 - (e) Defines an investment entity and sets out an exception to consolidating particular controlled entities of an investment entity.

Scope

3. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in the preparation and presentation of consolidated financial statements for the economic entity.**

Public Sector Combinations

4. This Standard does not deal with the accounting requirements for public sector combinations and their effect on consolidation, including goodwill arising on a public sector combination (see the relevant international or national accounting standard dealing with public sector combinations).

Presentation of Consolidated Financial Statements

5. **An entity that is a controlling entity shall present consolidated financial statements. This Standard applies to all entities, except as follows:**
 - (a) **A controlling entity need not present consolidated financial statements if it meets all the following conditions:**
 - (i) **It is itself a controlled entity and the information needs of users are met by its controlling entity's consolidated financial statements, and, in the case of a partially owned controlled entity, all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the entity not presenting consolidated financial statements;**
 - (ii) **Its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);**
 - (iii) **It did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market; and**

- (iv) **Its ultimate or any intermediate controlling entity produces consolidated financial statements that are available for public use and comply with International Public Sector Accounting Standards (IPSASs).**
 - (b) **Post-employment benefit plans or other long-term employee benefit plans to which IPSAS 25, *Employee Benefits*, applies.**
 - (c) **An investment entity reporting in accordance with IPSASs need not present consolidated financial statements if it is required, in accordance with paragraph 52 of this Standard, to measure all of its controlled entities at fair value through surplus or deficit.**
6. A controlled entity is not excluded from consolidation because its activities are dissimilar to those of the other entities within the economic entity, for example, the consolidation of Government Business Enterprises (GBEs) with entities in the budget sector. Relevant information is provided by consolidating such controlled entities and disclosing additional information in the consolidated financial statements about the different activities of controlled entities. For example, the disclosures required by IPSAS 18, *Segment Reporting*, help to explain the significance of different activities within the economic entity.

Government Business Enterprises

7. **This Standard applies to all public sector entities other than GBEs.**
8. The *Preface to International Public Sector Accounting Standards* issued by the IPSASB explains that GBEs apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.
9. Although GBEs are not required to comply with this Standard in their own financial statements, the provisions of this Standard will apply where a public sector entity that is not a GBE has one or more controlled entities that are GBEs. In these circumstances, this Standard shall be applied in consolidating GBEs into the financial statements of the economic entity.

Definitions

10. **The following terms are used in this Standard with the meanings specified:**

Benefits are the advantages an entity obtains from its involvement with other entities. Benefits may be financial or non-financial. Benefits can have positive or negative aspects.

Binding arrangement: For the purposes of this Standard, a binding arrangement is an arrangement that confers enforceable rights and obligations on the parties to it as if it were in the form of a contract. It includes rights from contracts or other legal rights.

Consolidated financial statements are the financial statements of an economic entity in which the assets, liabilities, net assets/equity, revenue, expenses and cash flows of the controlling entity and its controlled entities are presented as those of a single economic entity.

Control: 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 other entity.

A **controlled entity** is an entity that is controlled by another entity.

A controlling entity is an entity that controls one or more entities.

A decision-maker is an entity with decision-making rights that is either a principal or an agent for other parties.

An economic entity is a controlling entity and its controlled entities.

An investment entity is an entity that:

- (a) Obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
- (b) Has the purpose of investing funds solely for returns from capital appreciation, investment revenue, or both; and
- (c) Measures and evaluates the performance of substantially all of its investments on a fair value basis.

A non-controlling interest is the net assets/equity in a controlled entity not attributable, directly or indirectly, to a controlling entity.

Power consists of existing rights that give the current ability to direct the relevant activities of another entity, including the right to direct the financial and operating policies of that entity.

Protective rights are rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate.

Relevant activities (for the purpose of this Standard), are activities of the potentially controlled entity that significantly affect the nature or amount of the benefits that an entity receives from its involvement with that other entity.

Removal rights are rights to deprive the decision maker of its decision-making authority.

Terms defined in other IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately.

Binding Arrangement

11. Binding arrangements can be evidenced in several ways. A binding arrangement is often, but not always, in writing, in the form of a contract or documented discussions between the parties. Statutory mechanisms such as legislative or executive authority can also create enforceable arrangements, similar to contractual arrangements, either on their own or in conjunction with contracts between the parties.

Economic Entity

12. The term economic entity is used in this Standard to define, for financial reporting purposes, a group of entities comprising the controlling entity and any controlled entities. Other terms sometimes used to refer to an economic entity include administrative entity, financial entity, consolidated entity, and group. An economic entity may include entities with both social policy and commercial objectives.
13. The determination of the economic entity will need to be made having regard to user needs, the definition of an economic entity and the constitutional arrangements in a jurisdiction, in particular the ways in which government power is limited and allocated, and how the government system is

set up and operates. For example, in jurisdictions with an executive, legislature and judiciary, these may collectively form an economic entity in respect of which there is a user need for consolidated financial statements.

Control (see paragraphs AG2–AG86)

14. **An entity, regardless of the nature of its involvement with another entity, shall determine whether it is a controlling entity by assessing whether it controls the other entity.**
15. **An entity controls another entity when it 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 other entity.**
16. **Thus, an entity controls another entity if and only if the entity has all the following:**
 - (a) **Power over the other entity (see paragraphs 19–25);**
 - (b) **Exposure, or rights, to variable benefits from its involvement with the other entity (see paragraphs 26–30); and**
 - (c) **The ability to use its power over the other entity to affect the nature or amount of the benefits from its involvement with the other entity (see paragraphs 31–33).**
17. An entity shall consider all facts and circumstances when assessing whether it controls another entity. The entity shall reassess whether it controls another entity if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 16 (see paragraphs AG81–AG86).
18. Two or more entities collectively control another entity when they must act together to direct the relevant activities. In such cases, because no single entity can direct the activities without the co-operation of the others, no single entity controls the other entity. Each entity would account for its interest in the other entity in accordance with the relevant IPSASs, such as IPSAS XX (ED 51), *Joint Arrangements*, IPSAS XX (ED 50), *Investments in Associates and Joint Ventures*, or the IPSASs dealing with financial instruments (being IPSAS 28, *Financial Instruments: Presentation*, IPSAS 29, *Financial Instruments: Recognition and Measurement*, and IPSAS 30, *Financial Instruments: Disclosures*).

Power

19. An entity has power over another entity when the entity has existing rights that give it the current ability to direct the relevant activities, i.e., the activities that significantly affect the nature or amount of the benefits from its involvement with the other entity. The right to direct the financial and operating policies of another entity indicates that an entity has the ability to direct the relevant activities of another entity.
20. Power arises from rights. In some cases assessing power is straightforward, such as when power over another entity is obtained directly and solely from the voting rights granted by equity instruments such as shares, and can be assessed by considering the voting rights from those shareholdings. However, public sector entities often obtain power over another entity from rights other than voting rights. They may also obtain power over another entity without having an equity instrument providing evidence of a financial investment. An entity may have rights conferred by binding arrangements. These rights may give an entity power to require the other entity to deploy assets or incur liabilities in a way that affects the nature or amount of benefits received by the first-

mentioned entity. The assessment of whether such rights give rise to power over another entity may be complex and require more than one factor to be considered.

21. An entity can have power over another entity even if it does not have responsibility for the day-to-day operation of the other entity or the manner in which prescribed functions are performed by that other entity. Legislation may give statutory bodies or statutory officers powers to carry out their functions independently of government. For example, the Auditor-General and Government Statistician usually have statutory powers to obtain information and publish reports without recourse to government and the judiciary often has special powers to give effect to the concept of judicial independence. Legislation may also set out the broad parameters within which the statutory body is required to operate, and result in the statutory body operating in a manner consistent with the objectives set by Parliament or a similar body. The existence of statutory powers to operate independently does not, of itself, preclude an entity having the ability to direct the operating and financial policies of another entity with statutory powers so as to obtain benefits. For example, independence of a central bank in relation to monetary policy does not preclude the possibility of the central bank being controlled. All facts and circumstances would still need to be considered.
22. The existence of rights over another entity does not necessarily give rise to power for the purposes of this Standard. An entity does not have power over another entity solely due to the existence of:
 - (a) Regulatory control (see paragraph AG12); or
 - (b) Economic dependence (see paragraphs AG41–AG42).
23. An entity with the current ability to direct the relevant activities has power even if its rights to direct have yet to be exercised. Evidence that the entity has been directing the relevant activities of the entity being assessed for control can help determine whether the entity has power, but such evidence is not, in itself, conclusive in determining whether the entity has power over the entity being assessed for control.
24. If two or more entities each have existing rights that give them the unilateral ability to direct different relevant activities, the entity that has the current ability to direct the activities that most significantly affect the nature or amount of benefits from that entity has power over that other entity.
25. An entity can have power over an entity being assessed for control even if other entities have existing rights that give them the current ability to participate in the direction of the relevant activities, for example when another entity has significant influence. However, an entity that holds only protective rights does not have power over another entity (see paragraphs AG29–AG31), and consequently does not control the other entity.

Benefits

26. An entity is exposed, or has rights, to variable benefits from its involvement with an entity being assessed for control when the benefits from its involvement have the potential to vary as a result of the other entity's performance. The entity's benefits from its involvement with the entity being assessed for control can be only positive, only negative or both positive and negative.
27. The entity's benefits from its involvement with the entity being assessed for control can be only financial, only non-financial or both financial and non-financial. Financial benefits include returns on investment such as dividends or similar distributions and are sometimes referred to as returns. Non-financial benefits include advantages arising from scarce resources that are not measured in financial terms and economic benefits received directly by service recipients of the entity. Non-

financial benefits can occur when the activities of another entity are congruent with, (that is, they are in agreement with), the objectives of the entity and support the entity in achieving its objectives. Congruent activities may be undertaken voluntarily or the entity may have the power to direct the other entity to undertake those activities. Non-financial benefits can also occur when two entities have complementary objectives (that is, the objectives of one entity add to, and make more complete, the objectives of the other entity).

28. The following examples illustrate financial benefits that an entity may receive from its involvement with another entity:
 - (a) Dividends, variable interest on debt securities, other distributions of economic benefits;
 - (b) Exposure to increases or decreases in the value of an investment in another entity;
 - (c) Exposure to loss from agreements to provide financial support, including financial support for major projects;
 - (d) Cost savings (for example, if an entity would achieve economies of scale or synergies by combining the operations or assets of the other entity with its own operations or assets);
 - (e) Residual interests in the other entity's assets and liabilities on liquidation of that other entity; and
 - (f) Other exposures to variable benefits that are not available to other entities.
29. Examples of non-financial benefits include:
 - (a) The ability to benefit from the specialized knowledge of another entity;
 - (b) The value to the entity of the other entity undertaking activities that assist the entity in achieving its objectives;
 - (c) Improved outcomes;
 - (d) More efficient delivery of outcomes;
 - (e) More efficient or effective production and delivery of goods and services;
 - (f) Having an asset and related services available earlier than otherwise would be the case; and
 - (g) Having a higher level of service quality than would otherwise be the case.
30. Although only one entity can control another entity, more than one party can share in the benefits of that other entity. For example, holders of non-controlling interests can share in the financial benefits such as surpluses or distributions from an entity or the non-financial benefits such as congruence of activities with desired outcomes.

Link between Power and Benefits

31. An entity controls another entity if the entity not only has power over the entity being assessed for control and exposure or rights to variable benefits from its involvement with the other entity, but also has the ability to use its power to affect the nature or amount of the benefits from its involvement with the entity being assessed for control.
32. The existence of congruent objectives alone is insufficient for an entity to conclude that it controls another entity. In order to have control the entity would also need to have the ability to use its

power over the entity being assessed for control to direct that other entity to work with it to further its objectives.

33. An entity with decision-making rights shall determine whether it is a principal or an agent. An entity shall also determine whether another entity with decision-making rights is acting as an agent for the entity. An agent is a party primarily engaged to act on behalf and for the benefit of another party or parties (the principal(s)) and therefore does not control the other entity when it exercises its decision-making authority. Thus, sometimes a principal's power may be held and exercisable by an agent, but on behalf of the principal.

Accounting Requirements

34. **A controlling entity shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.**
35. Consolidation of a controlled entity shall begin from the date the entity obtains control of the other entity and cease when the entity loses control of the other entity.

Consolidation Procedures

36. Consolidated financial statements:
 - (a) Combine like items of assets, liabilities, net assets/equity, revenue, expenses and cash flows of the controlling entity with those of its controlled entities.
 - (b) Offset (eliminate) the carrying amount of the controlling entity's investment in each controlled entity and the controlling entity's portion of net assets/equity of each controlled entity (the relevant international or national accounting standards explain how to account for any related goodwill).
 - (c) Eliminate in full intra-economic entity assets and liabilities, net assets/equity, revenue, expenses and cash flows relating to transactions between entities of the economic entity (surpluses or deficits resulting from intra-economic entity transactions that are recognized in assets, such as inventory and fixed assets, are eliminated in full). Intra-economic entity losses may indicate an impairment that requires recognition in the consolidated financial statements.

Uniform Accounting Policies

37. If a member of the economic entity uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to that member's financial statements in preparing the consolidated financial statements to ensure conformity with the economic entity's accounting policies.

Measurement

38. An entity includes the revenue and expenses of a controlled entity in the consolidated financial statements from the date it gains control until the date when the entity ceases to control the controlled entity. Revenue and expenses of the controlled entity are based on the amounts of the assets and liabilities recognized in the consolidated financial statements at the acquisition date. For example, depreciation expense recognized in the consolidated statement of financial performance

after the acquisition date is based on the values of the related depreciable assets recognized in the consolidated financial statements at the acquisition date.

Potential Voting Rights

39. When potential voting rights, or other derivatives containing potential voting rights, exist, the proportion of surplus or deficit and changes in net assets/equity allocated to the controlling entity and non-controlling interests in preparing consolidated financial statements is determined solely on the basis of existing ownership interests and does not reflect the possible exercise or conversion of potential voting rights and other derivatives, unless paragraph 40 applies.
40. In some circumstances an entity has, in substance, an existing ownership interest as a result of a transaction that currently gives the entity access to the benefits associated with an ownership interest. In such circumstances, the proportion allocated to the controlling entity and non-controlling interests in preparing consolidated financial statements is determined by taking into account the eventual exercise of those potential voting rights and other derivatives that currently give the entity access to the benefits.
41. IPSAS 28 and IPSAS 29 do not apply to interests in controlled entities that are consolidated. When instruments containing potential voting rights in substance currently give access to the benefits associated with an ownership interest in a controlled entity, the instruments are not subject to the requirements of IPSAS 28 and IPSAS 29. In all other cases, instruments containing potential voting rights in a controlled entity are accounted for in accordance with IPSAS 28 and IPSAS 29.

Reporting Dates

42. The financial statements of the controlling entity and its controlled entities used in the preparation of the consolidated financial statements shall be prepared as at the same reporting date. When the end of the reporting period of the controlling entity is different from that of a controlled entity, the controlling entity either:
 - (a) Obtains, for consolidation purposes, additional financial information as of the same date as the financial statements of the controlling entity; or
 - (b) Uses the most recent financial statements of the controlled entity adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements.

Non-Controlling Interests

43. A controlling entity shall present non-controlling interests in the consolidated statement of financial position within net assets/equity, separately from the net assets/equity of the owners of the controlling entity.
44. Changes in a controlling entity's interest in a controlled entity that do not result in the controlling entity losing control of the controlled entity are transactions with owners in their capacity as owners.
45. An entity shall attribute the surplus or deficit and each gain or loss recognized directly in net assets/equity to the owners of the controlling entity and to the non-controlling interests. The entity shall also attribute the total amount recognized in the statement of changes in net assets/equity to the owners of the controlling entity and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

46. If a controlled entity has outstanding cumulative preference shares that are classified as equity instruments and are held by non-controlling interests, the entity shall compute its share of surplus or deficit after adjusting for the dividends on such shares, whether or not such dividends have been declared.

Changes in the Proportion held by Non-Controlling Interests

47. When the proportion of the net assets/equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the controlled entity. The entity shall recognize directly in net assets/equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the controlling entity.

Loss of Control

48. If a controlling entity loses control of a controlled entity, the controlling entity:
- (a) Derecognizes the assets and liabilities of the former controlled entity from the consolidated statement of financial position;
 - (b) Recognizes any investment retained in the former controlled entity at its fair value when control is lost and subsequently accounts for it and for any amounts owed by or to the former controlled entity in accordance with relevant IPSASs. That fair value shall be regarded as the fair value on initial recognition of a financial asset in accordance with IPSAS 29 or, when appropriate, the cost on initial recognition of an investment in an associate or joint venture; and
 - (c) Recognizes the gain or loss associated with the loss of control attributable to the former controlling interest.
49. A controlling entity might lose control of a controlled entity in two or more arrangements (transactions). However, sometimes circumstances indicate that the multiple arrangements should be accounted for as a single transaction. In determining whether to account for the arrangements as a single transaction, a controlling entity shall consider all the terms and conditions of the arrangements and their economic effects. One or more of the following indicate that the controlling entity should account for the multiple arrangements as a single transaction:
- (a) They are entered into at the same time or in contemplation of each other.
 - (b) They form a single transaction designed to achieve an overall commercial effect.
 - (c) The occurrence of one arrangement is dependent on the occurrence of at least one other arrangement.
 - (d) One arrangement considered on its own is not economically justified, but it is economically justified when considered together with other arrangements. An example is when a disposal of an investment is priced below market and is compensated for by a subsequent disposal priced above market.
50. If a controlling entity loses control of a controlled entity, it shall:
- (a) Derecognize:

- (i) The assets (including any goodwill) and liabilities of the controlled entity at their carrying amounts at the date when control is lost; and
 - (ii) The carrying amount of any non-controlling interests in the former controlled entity at the date when control is lost (including any gain or loss recognized directly in net assets/equity attributable to them).
- (b) Recognize:
- (i) The fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control;
 - (ii) If the transaction, event or circumstances that resulted in the loss of control involves a distribution of shares of the controlled entity to owners in their capacity as owners, that distribution; and
 - (iii) Any investment retained in the former controlled entity at its fair value at the date when control is lost.
- (c) Transfer directly to accumulated surplus/deficit, if required by other IPSASs, the amounts recognized directly in net assets/equity in relation to the controlled entity on the basis described in paragraph 51.
- (d) Recognize any resulting difference as a gain or loss in surplus or deficit attributable to the controlling entity.
51. If a controlling entity loses control of a controlled entity, the controlling entity shall account for all amounts previously recognized directly in net assets/equity in relation to that controlled entity on the same basis as would be required if the controlling entity had directly disposed of the related assets or liabilities. If a revaluation surplus previously recognized directly in net assets/equity would be transferred directly to accumulated surplus/deficit on the disposal of the asset, the controlling entity shall transfer the revaluation surplus directly to accumulated surplus/deficit when it loses control of the controlled entity.

Investment Entities: Fair Value Requirement

52. **Except as described in paragraph 53, an investment entity shall not consolidate its controlled entities. Instead, an investment entity shall measure an investment in a controlled entity at fair value through surplus or deficit in accordance with IPSAS 29.**
53. Notwithstanding the requirement in paragraph 52, if an investment entity has a controlled entity that provides services that relate to the investment entity's investment activities (see paragraphs AG97–AG99), it shall consolidate that controlled entity in accordance with paragraphs 34–51 of this Standard.
54. **A controlling entity of an investment entity that is not itself an investment entity shall present consolidated financial statements in which it (i) measures the investments of a controlled investment entity at fair value through surplus or deficit in accordance with IPSAS 29 and shall consolidate the other assets and liabilities and revenue and expenses of the controlled investment entity in accordance with paragraphs 34–51 of this Standard.**

Determining Whether an Entity is an Investment Entity

55. An entity shall consider all facts and circumstances when assessing whether it is an investment entity, including its purpose and design. Paragraphs AG88–AG105 describe aspects of the definition of an investment entity in more detail. If facts and circumstances indicate that there are changes to one or more of the three elements that make up the definition of an investment entity, a controlling entity shall reassess whether it is an investment entity.
56. A controlling entity that either ceases to be an investment entity or becomes an investment entity shall account for the change in its status prospectively from the date at which the change in status occurred (see paragraphs 59–60).

Judgments and Assumptions

57. An investment entity shall disclose the information required by paragraph 14 of IPSAS XX (ED 52), *Disclosure of Interests in Other Entities*, about significant judgments and assumptions made in determining that it is an investment entity unless it has all of the following characteristics:
 - (a) It has obtained funds from more than one investor (see paragraphs AG88–AG89);
 - (b) It has ownership interests in the form of equity or similar interests (see paragraphs AG90–AG91); and
 - (c) It has more than one investment (see paragraphs AG95–AG96).
58. The absence of any of these characteristics does not necessarily disqualify an entity from being classified as an investment entity. However, the absence of any of these characteristics means that an entity is required to disclose information about the significant judgments and assumptions made in determining that it is an investment entity.

Accounting for a Change in Investment Entity Status

59. **When an entity ceases to be an investment entity, it shall apply the relevant international or national accounting standard dealing with public sector combinations to any controlled entity that was previously measured at fair value through surplus or deficit in accordance with paragraph 52. The date of the change of status shall be the deemed acquisition date. The fair value of the controlled entity at the deemed acquisition date shall represent the transferred deemed consideration when measuring any goodwill or gain from a bargain purchase that arises from the deemed acquisition. All controlled entities shall be consolidated in accordance with paragraphs 34–47 of this Standard from the date of change of status.**
60. When an entity becomes an investment entity, it shall cease to consolidate its controlled entities at the date of the change in status, except for any controlled entity that shall continue to be consolidated in accordance with paragraph 53. The investment entity shall apply the requirements of paragraphs 48 and 49 to those controlled entities that it ceases to consolidate as though the investment entity had lost control of those controlled entities at that date.

Transitional Provisions

61. **An entity shall apply this Standard retrospectively, in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, except as specified in paragraphs 62–76.**

62. Notwithstanding the requirements of paragraph 33 of IPSAS 3, when this Standard is first applied an entity need only present the quantitative information required by paragraph 33(f) of IPSAS 3 for the annual period immediately preceding the date of initial application of this Standard (the “immediately preceding period”). An entity may also present this information for the current period or for earlier comparative periods, but is not required to do so.
63. For the purposes of this Standard, the date of initial application is the beginning of the annual reporting period for which this Standard is applied for the first time.
64. At the date of initial application, an entity is not required to make adjustments to the previous accounting for its involvement with either:
- (a) Entities that would be consolidated at that date in accordance with IPSAS 6, *Consolidated and Separate Financial Statements* (December 2006), and are still consolidated in accordance with this Standard; or
 - (b) Entities that would not be consolidated at that date in accordance with IPSAS 6 (December 2006), and are not consolidated in accordance with this Standard.
65. At the date of initial application, an entity shall assess whether it is an investment entity on the basis of the facts and circumstances that exist at that date. If, at the date of initial application, an entity concludes that it is an investment entity, it shall apply the requirements of paragraphs 66–69 instead of paragraphs 73–74.
66. Except for any controlled entity that is consolidated in accordance with paragraph 53 (to which paragraph 64 or paragraphs 73–74, whichever is relevant, apply), an investment entity shall measure its investment in each controlled entity at fair value through surplus or deficit as if the requirements of this Standard had always been effective. The investment entity shall retrospectively adjust both the annual period that immediately precedes the date of initial application and net assets/equity at the beginning of the immediately preceding period for any difference between:
- (a) The previous carrying amount of the controlled entity; and
 - (b) The fair value of the investment entity’s investment in the controlled entity.
- The cumulative amount of any fair value adjustments previously recognized directly in net assets/equity shall be transferred to accumulated surplus/deficit at the beginning of the annual period immediately preceding the date of initial application.
67. An investment entity shall use the fair value amounts that were previously reported to investors or to management.
68. If measuring an investment in a controlled entity in accordance with paragraph 66 is impracticable (as defined in IPSAS 3), an investment entity shall apply the requirements of this Standard at the beginning of the earliest period for which application of paragraph 66 is practicable, which may be the current period. The investor shall retrospectively adjust the annual period that immediately precedes the date of initial application, unless the beginning of the earliest period for which application of this paragraph is practicable is the current period. If this is the case, the adjustment to net assets/equity shall be recognized at the beginning of the current period.
69. If an investment entity has disposed of, or has lost control of, an investment in a controlled entity before the date of initial application of this Standard, the investment entity is not required to make adjustments to the previous accounting for that controlled entity.

70. If, at the date of initial application, an entity concludes that it shall consolidate another entity that was not consolidated in accordance with IPSAS 6 (December 2006), the entity shall measure the assets, liabilities and non-controlling interests in that previously unconsolidated entity as if that other entity had been consolidated from the date when the entity obtained control of that other entity on the basis of the requirements of this Standard. The entity shall adjust retrospectively the annual period immediately preceding the date of initial application. When the date that control was obtained is earlier than the beginning of the immediately preceding period, the entity shall recognize, as an adjustment to net assets/equity at the beginning of the immediately preceding period, any difference between:
- (a) The amount of assets, liabilities and non-controlling interests recognized; and
 - (b) The previous carrying amount of the entity's involvement with the other entity.
71. If measuring a controlled entity's assets, liabilities and non-controlling interests in accordance with paragraph 70(a) or (b) is impracticable (as defined in IPSAS 3), an entity shall measure the assets, liabilities and non-controlling interests in that previously unconsolidated entity as if that entity had been consolidated from the deemed acquisition date. The deemed acquisition date shall be the beginning of the earliest period for which the application of this paragraph is practicable, which may be the current period.
72. The entity shall adjust retrospectively the annual period immediately preceding the date of initial application, unless the beginning of the earliest period for which application of this paragraph is practicable is the current period. When the deemed acquisition date is earlier than the beginning of the immediately preceding period, the entity shall recognize, as an adjustment to net assets/equity at the beginning of the immediately preceding period, any difference between:
- (a) The amount of assets, liabilities and non-controlling interests recognized; and
 - (b) The previous carrying amounts of the entity's involvement with the other entity.
- If the earliest period for which application of this paragraph is practicable is the current period, the adjustment to net assets/equity shall be recognized at the beginning of the current period.
73. If, at the date of initial application, an entity concludes that it will no longer consolidate an entity that was consolidated in accordance with IPSAS 6 (December 2006), the entity shall measure its interest in the other entity at the amount at which it would have been measured if the requirements of this Standard had been effective when the entity became involved with, or lost control of, the other entity. The entity shall adjust retrospectively the annual period immediately preceding the date of initial application. When the date that the entity became involved with (but did not obtain control in accordance with this Standard), or lost control of, the other entity is earlier than the beginning of the immediately preceding period, the entity shall recognize, as an adjustment to net assets/equity at the beginning of the immediately preceding period, any difference between:
- (a) The previous carrying amount of the assets, liabilities and non-controlling interests; and
 - (b) The recognized amount of the entity's interest in the other entity.
74. If measuring the interest in the other entity in accordance with paragraph 73 is impracticable (as defined in IPSAS 3), an entity shall apply the requirements of this Standard at the beginning of the earliest period for which application of paragraph 73 is practicable, which may be the current period. The entity shall adjust retrospectively the annual period immediately preceding the date of initial application, unless the beginning of the earliest period for which application of this paragraph

is practicable is the current period. When the date that the entity became involved with (but did not obtain control in accordance with this Standard), or lost control of, the other entity is earlier than the beginning of the immediately preceding period, the entity shall recognize, as an adjustment to net assets/equity at the beginning of the immediately preceding period, any difference between:

- (a) The previous carrying amount of the assets, liabilities and non-controlling interests; and
- (b) The recognized amount of the entity's interest in the other entity.

If the earliest period for which application of this paragraph is practicable is the current period, the adjustment to net assets/equity shall be recognized at the beginning of the current period.

References to the “Immediately Preceding Period”

- 75. Notwithstanding the references to the annual period immediately preceding the date of initial application (the “immediately preceding period”) in paragraphs 70–74, an entity may also present adjusted comparative information for any earlier periods presented, but is not required to do so. If an entity does present adjusted comparative information for any earlier periods, all references to the “immediately preceding period” in paragraphs 70–74 shall be read as the “earliest adjusted comparative period presented.”
- 76. If an entity presents unadjusted comparative information for any earlier periods, it shall clearly identify the information that has not been adjusted, state that it has been prepared on a different basis, and explain that basis.

Effective Date

- 77. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after [Date]. Earlier application is encouraged. If an entity applies this Standard for a period beginning before [Date], it shall disclose that fact and apply IPSAS XX (ED 48), *Separate Financial Statements*, IPSAS XX (ED 50), IPSAS XX (ED 51), and IPSAS XX (ED 52), at the same time.**
- 78. When an entity adopts the accrual basis of accounting as defined by IPSASs for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

Withdrawal of IPSAS 6 (December 2006)

- 79. **This Standard is issued concurrently with IPSAS XX (ED 48). Together, the two Standards supersede IPSAS 6 (December 2006).**

Appendix A

Application Guidance

This Appendix is an integral part of IPSAS XX (ED 49), Consolidated Financial Statements.

AG1. The examples in this appendix portray hypothetical situations. Although some aspects of the examples may be present in actual fact patterns, all facts and circumstances of a particular fact pattern would need to be evaluated when applying IPSAS XX (ED 49), *Consolidated Financial Statements*.

Assessing Control

AG2. To determine whether it controls another entity an entity shall assess whether it has all the following:

- (a) Power over the other entity;
- (b) Exposure, or rights, to variable benefits from its involvement with the other entity; and
- (c) The ability to use its power over the other entity to affect the nature or amount of the benefits from its involvement with the other entity.

AG3. Consideration of the following factors may assist in making that determination:

- (a) The purpose and design of the other entity (see paragraphs AG5–AG8);
- (b) What the relevant activities are and how decisions about those activities are made (see paragraphs AG13–AG15);
- (c) Whether the rights of the entity give it the current ability to direct the relevant activities of the other entity (see paragraphs AG16–AG56);
- (d) Whether the entity is exposed, or has rights, to variable benefits from its involvement with the other entity (see paragraph AG57–AG58); and
- (e) Whether the entity has the ability to use its power over the other entity to affect the nature or amount of the benefits from its involvement with the other entity (see paragraphs AG59–AG73).

AG4. When assessing whether it controls another entity, an entity shall consider the nature of its relationship with other parties (see paragraphs AG74–AG76).

Purpose and Design of another Entity

AG5. An entity shall consider the purpose and design of the entity being assessed for control in order to identify the relevant activities, how decisions about the relevant activities are made, who has the current ability to direct those activities and who benefits from those activities.

AG6. When the purpose and design of the entity being assessed for control are considered, it may be clear that the entity being assessed for control is controlled by means of equity instruments that give the holder proportionate voting rights, such as ordinary shares. In this case, in the absence of any additional arrangements that alter decision-making, the

assessment of control focuses on which party, if any, is able to exercise voting rights sufficient to determine the operating and financing policies of the entity being assessed for control (see paragraphs AG32–AG52). In the most straightforward case, the entity that holds a majority of those voting rights, in the absence of any other factors, controls the other entity.

- AG7. To determine whether an entity controls another entity in more complex cases, it may be necessary to consider some or all of the other factors in paragraph AG3.
- AG8. Voting rights may not be the dominant factor in deciding who controls the entity being assessed for control. If there are voting rights they may be limited in scope. The relevant activities of the entity being assessed for control may be directed by means of binding arrangements (including statutory arrangements, rights from contracts or other legal rights) or provisions in founding documents such as articles of association or a constitution. In such cases, an entity's consideration of the purpose and design of the entity being assessed for control shall also include consideration of the risks to which the other entity was designed to be exposed, the risks it was designed to pass on to the parties involved and whether the entity is exposed to some or all of those risks. Consideration of the risks includes not only the downside risk, but also the potential for upside.

Power

- AG9. To have power over another entity, an entity must have existing rights that give it the current ability to direct the relevant activities. For the purpose of assessing power, only substantive rights and rights that are not protective shall be considered (see paragraphs AG25–AG31).
- AG10. The determination about whether an entity has power depends on the relevant activities, the way decisions about the relevant activities are made and the rights of the entity and other entities in relation to the potentially controlled entity.
- AG11. An entity normally will have power over an entity that it has established when the constituting document or enabling legislation specifies the operating and financing activities that are to be carried out by that entity. However, the impact of the constituting document or legislation is evaluated in the light of other prevailing circumstances, as all facts and circumstances need to be considered in assessing whether an entity has power over another entity. For example, a government may not have power over a research and development corporation that operates under a mandate created, and limited, by legislation if that or other legislation assigns power to direct the relevant activities to other entities that are not controlled by the government.

Regulatory Control

- AG12. Regulatory control does not usually give rise to power over an entity for the purposes of this Standard. Governments and other public sector bodies, including supranational bodies, may have wide ranging powers to establish the regulatory framework within which entities operate, to impose conditions or sanctions on their operations and to enforce those conditions or sanctions. For example, governments and other public sector bodies may enact regulations to protect the health and safety of the community, restrict the sale or use of dangerous goods or specify the pricing policies of monopolies. However, when regulation is so tight as to effectively dictate how the entity performs its business, then it may be necessary to consider

whether the purpose and design of the entity is such that it is controlled by the regulating entity.

Relevant Activities and Direction of Relevant Activities

AG13. For many entities, a range of operating and financing activities significantly affect the benefits they generate. Any activity that assists in achieving or furthering the objectives of a controlled entity may affect the benefits to the controlling entity. Examples of activities that, depending on the circumstances, can be relevant activities include, but are not limited to:

- (a) Using assets and incurring liabilities to provide services to service recipients;
- (b) Distributing funds to specified individuals or groups;
- (c) Collecting revenue through non-exchange transactions;
- (d) Selling and purchasing of goods or services;
- (e) Managing physical assets;
- (f) Managing financial assets during their life (including upon default);
- (g) Selecting, acquiring or disposing of assets;
- (h) Managing a portfolio of liabilities;
- (i) Researching and developing new products or processes; and
- (j) Determining a funding structure or obtaining funding.

AG14. Examples of decisions about relevant activities include but are not limited to:

- (a) Establishing operating and capital decisions of an entity, including budgets; and
- (b) Appointing and remunerating an entity's key management personnel or service providers and terminating their services or employment.

AG15. In some situations, activities both before and after a particular set of circumstances arises or event occurs, may be relevant activities. When two or more entities have the current ability to direct relevant activities and those activities occur at different times, those entities shall determine which entity is able to direct the activities that most significantly affect those benefits consistently with the treatment of concurrent decision-making rights (see paragraph 22). The entities concerned shall reconsider this assessment over time if relevant facts or circumstances change.

Rights that Give an Entity Power over another Entity

AG16. Power arises from rights. To have power over another entity, an entity must have existing rights that give the entity the current ability to direct the relevant activities of the other entity. The rights that may give an entity power can differ.

AG17. Examples of rights that, either individually or in combination, can give an entity power include but are not limited to:

- (a) Rights to give policy directions to the governing body of another entity that give the holder the ability to direct the relevant activities of the other entity;

- (b) Rights in the form of voting rights (or potential voting rights) of another entity (see paragraphs AG32–AG52);
- (c) Rights to appoint, reassign or remove members of another entity's key management personnel who have the ability to direct the relevant activities;
- (d) Rights to appoint or remove another entity that directs the relevant activities;
- (e) Rights to approve or veto operating and capital budgets relating to the relevant activities of another entity;
- (f) Rights to direct the other entity to enter into, or veto any changes to, transactions for the benefit of the entity;
- (g) Rights to veto key changes to the other entity, such as the sale of a major asset or of the other entity as a whole; and
- (h) Other rights (such as decision-making rights specified in a management contract) that give the holder the ability to direct the relevant activities.

AG18. In considering whether it has power, an entity will need to consider the mechanism(s) by which it has obtained power. Ways in which an entity may have obtained power, either individually or in combination with other arrangements, include:

- (a) Legislative or executive authority;
- (b) Administrative arrangements;
- (c) Contractual arrangements;
- (d) Founding documents (for example, articles of association); and
- (e) Voting or similar rights.

AG19. To determine whether an entity has rights sufficient to give it power, the entity shall also consider the purpose and design of the other entity (see paragraphs AG5–AG8) and the requirements in paragraphs AG53–AG56 together with paragraphs AG20–AG22.

AG20. In some circumstances it may be difficult to determine whether an entity's rights are sufficient to give it power over another entity. In such cases, to enable the assessment of power to be made, the entity shall consider evidence of whether it has the practical ability to direct the relevant activities unilaterally. Consideration is given, but is not limited, to the following, which, when considered together with its rights and the indicators in paragraphs AG21 and AG22, may provide evidence that the entity's rights are sufficient to give it power over the other entity:

- (a) The entity can, without having the contractual right to do so, appoint or approve the other entity's key management personnel who have the ability to direct the relevant activities;
- (b) The entity can, without having the contractual right to do so, direct the other entity to enter into, or can veto any changes to, significant transactions for the benefit of the entity;

- (c) The entity can dominate either the nominations process for electing members of the other entity's governing body or the obtaining of proxies from other holders of voting rights;
- (d) The other entity's key management personnel are related parties of the entity (for example, the chief executive officer of the other entity and the chief executive officer of the entity are the same person); or
- (e) The majority of the members of the other entity's governing body are related parties of the entity.

AG21. Sometimes there will be indications that the entity has a special relationship with the other entity, which suggests that the entity has more than a passive interest in the other entity. The existence of any individual indicator, or a particular combination of indicators, does not necessarily mean that the power criterion is met. However, if an entity has more than a passive interest in another entity this may indicate that the entity has other related rights sufficient to give it power or provide evidence of existing power over another entity. For example, the following suggests that the entity has more than a passive interest in the other entity and, in combination with other rights, may indicate power:

- (a) The relationship between the entity and the other entity's operations is one of dependence, such as in the following situations:
 - (i) The entity funds a significant portion of the other entity's operations and the other entity depends on this.
 - (ii) The entity guarantees a significant portion of the other entity's obligations, and the other entity depends on this.
 - (iii) The entity provides critical services, technology, supplies or raw materials to the other entity, and the other entity depends on this.
 - (iv) The entity controls assets such as licenses or trademarks that are critical to the other entity's operations and the other entity depends on this.
 - (v) The entity provides key management personnel to the other entity (for example, when the entity's personnel have specialized knowledge of the other entity's operations) and the other entity depends on this.
- (b) A significant portion of the other entity's activities either involve or are conducted on behalf of the entity.
- (c) The entity's exposure, or rights, to benefits from its involvement with the other entity is disproportionately greater than its voting or other similar rights. For example, there may be a situation in which an entity is entitled, or exposed, to more than half of the benefits of the other entity but holds less than half of the voting rights of the other entity.

AG22. Public sector entities often have special relationships with other parties as a result of the indicators listed in paragraph AG21. Public sector entities often fund the activities of other entities. Economic dependence is discussed in paragraphs AG 41 to AG42.

AG23. The greater an entity's exposure, or rights, to variability of benefits from its involvement with another entity, the greater is the incentive for the entity to obtain rights sufficient to give it power. Therefore, having a large exposure to variability of benefits is an indicator that the

entity may have power. However, the extent of the entity's exposure does not, in itself, determine whether an entity has power over the other entity.

- AG24. When the factors set out in paragraph AG20 and the indicators set out in paragraphs AG21–AG23 are considered together with an entity's rights, greater weight shall be given to the evidence of power described in paragraph AG20.

Substantive Rights

- AG25. An entity, in assessing whether it has power, considers only substantive rights relating to another entity (held by the entity and others). For a right to be substantive, the holder must have the practical ability to exercise that right.

- AG26. Determining whether rights are substantive requires judgment, taking into account all facts and circumstances. Factors to consider in making that determination include but are not limited to:

- (a) Whether there are any barriers (economic or otherwise) that prevent the holder (or holders) from exercising the rights. Examples of such barriers include but are not limited to:
 - (i) Financial penalties and incentives that would prevent (or deter) the holder from exercising its rights.
 - (ii) An exercise or conversion price that creates a financial barrier that would prevent (or deter) the holder from exercising its rights.
 - (iii) Terms and conditions that make it unlikely that the rights would be exercised, for example, conditions that narrowly limit the timing of their exercise.
 - (iv) The absence of an explicit, reasonable mechanism in the founding documents of another entity or in applicable laws or regulations that would allow the holder to exercise its rights.
 - (v) The inability of the holder of the rights to obtain the information necessary to exercise its rights.
 - (vi) Operational barriers or incentives that would prevent (or deter) the holder from exercising its rights (e.g., the absence of other managers willing or able to provide specialized services or provide the services and take on other interests held by the incumbent manager).
 - (vii) Legal or regulatory requirements that limit the manner in which rights may be exercised or that prevent the holder from exercising its rights (e.g., where another entity has statutory powers which permit it to operate independently of the government or where a foreign entity is prohibited from exercising its rights).
- (b) When the exercise of rights requires the agreement of more than one party, or when the rights are held by more than one party, whether a mechanism is in place that provides those parties with the practical ability to exercise their rights collectively if they choose to do so. The lack of such a mechanism is an indicator that the rights may not be substantive. The more parties that are required to agree to exercise the rights, the less likely it is that those rights are substantive. However, a board of directors (or other

governing body) whose members are independent of the decision maker may serve as a mechanism for numerous entities (or other parties) to act collectively in exercising their rights. Therefore, removal rights exercisable by an independent board of directors (or other governing body) are more likely to be substantive than if the same rights were exercisable individually by a large number of entities (or other parties).

- (c) Whether the party or parties that hold the rights would benefit from the exercise of those rights. For example, the holder of potential voting rights in another entity (see paragraphs AG49–AG52) shall consider the exercise or conversion price of the instrument. The terms and conditions of potential voting rights are more likely to be substantive when the instrument is in the money or the entity would benefit for other reasons (e.g., by realizing synergies between the entity and the other entity) from the exercise or conversion of the instrument.

AG27. To be substantive, rights also need to be exercisable when decisions about the direction of the relevant activities need to be made. Usually, to be substantive, the rights need to be currently exercisable. However, sometimes rights can be substantive, even though the rights are not currently exercisable.

AG28. Substantive rights exercisable by other parties can prevent an entity from controlling the entity being assessed for control to which those rights relate. Such substantive rights do not require the holders to have the ability to initiate decisions. As long as the rights are not merely protective (see paragraphs AG29–AG31), substantive rights held by other parties may prevent the entity from controlling the entity being assessed for control even if the rights give the holders only the current ability to approve or block decisions that relate to the relevant activities.

Protective Rights

AG29. In evaluating whether rights give an entity power over another entity, the entity shall assess whether its rights, and rights held by others, are protective rights. Protective rights relate to fundamental changes to the activities of another entity or apply in exceptional circumstances. However, not all rights that apply in exceptional circumstances or are contingent on events are protective (see paragraphs AG15 and AG55).

AG30. Because protective rights are designed to protect the interests of their holder without giving that party power over the entity to which those rights relate, an entity that holds only protective rights cannot have power or prevent another party from having power over the entity to which those rights relate (see paragraph 25).

AG31. Examples of protective rights include but are not limited to:

- (a) A lender's right to restrict a borrower from undertaking activities that could significantly change the credit risk of the borrower to the detriment of the lender.
- (b) The right of a party holding a non-controlling interest in an entity to approve capital expenditure greater than that required in the ordinary course of business, or to approve the issue of equity or debt instruments.
- (c) The right of a lender to seize the assets of a borrower if the borrower fails to meet specified loan repayment conditions.

- (d) The right of a regulator to curtail or close the operations of entities that are not complying with regulations or other requirements. For example, a pollution control authority may be able to close down activities of an entity that breaches environmental regulations.
- (e) The right to remove members of the governing body of another entity under certain restricted circumstances. For example, a state government may be able to remove or suspend the chairman of a municipality and appoint an administrator if the municipality is unable to make timely decisions about key policies.
- (f) The right of the government to remove tax deductibility for contributions to a not-for-profit entity if the entity significantly changes its objectives or activities.
- (g) The right of an entity providing resources to a charity to demand that, if the charity were to be liquidated, the net assets of the charity would be distributed to an organization undertaking similar activities. (However, if the entity had the power to determine specifically to where the charity's net assets would be distributed upon liquidation, the entity would have substantive rights in relation to the charity).

Voting Rights

AG32. Where an entity has voting or similar rights in respect of another entity, an entity should consider whether those rights give it the current ability to direct the relevant activities of the other entity. An entity considers the requirements in this section (paragraphs AG33–AG52) in making that assessment.

Power with a Majority of the Voting Rights

AG33. An entity that holds more than half of the voting rights of another entity has power in the following situations, unless paragraph AG34 or paragraph AG35 applies:

- (a) The relevant activities are directed by a vote of the holder of the majority of the voting rights; or
- (b) A majority of the members of the governing body that directs the relevant activities are appointed by a vote of the holder of the majority of the voting rights.

Majority of the Voting Rights but no Power

AG34. For an entity that holds more than half of the voting rights of another entity, to have power over that other entity, the entity's voting rights must be substantive, in accordance with paragraphs AG25–AG28, and must provide the entity with the current ability to direct the relevant activities, which often will be through determining operating and financing policies. If another entity has existing rights that provide that entity with the right to direct the relevant activities and that entity is not an agent of the entity making the assessment of control, the entity making the assessment of control does not have power over the other entity.

AG35. An entity does not have power over another entity, even though the entity holds the majority of the voting rights in the other entity, when those voting rights are not substantive. For example, an entity that has more than half of the voting rights in another entity cannot have power if the relevant activities are subject to direction by a government, court, administrator, receiver, liquidator or regulator.

Power without a Majority of the Voting Rights

AG36. An entity can have power even if it holds less than a majority of the voting rights of another entity. An entity can have power with less than a majority of the voting rights of another entity, for example, through:

- (a) The power to appoint or remove a majority of the members of the board of directors (or other governing body), and control of the other entity is by that board or by that body (see paragraph AG38);
- (b) A binding arrangement between the entity and other vote holders (see paragraph AG39);
- (c) Rights arising from other binding arrangements or rights arising from legislative or executive authority (see paragraph AG40);
- (d) The entity's voting rights (see paragraphs AG37 and AG44–AG48);
- (e) Potential voting rights (see paragraphs AG49–AG52); or
- (f) A combination of (a)–(e).

Special Voting Rights Attaching to Ownership Interests (Golden Shares)

AG37. An entity may have the right of decisive vote, thus to veto all other voting rights of another entity. This type of right is sometimes referred to as a “golden share”. Usually these rights are documented in the founding documents of the other entity (such as articles of association), and are designed to restrict the level of voting or other rights that may be held by certain parties. They may also give an entity veto powers over any major change in the other entity, such as the sale of a major asset or of the other entity as a whole.

Control of the Board or Other Governing Body

AG38. An entity may have the power to appoint or remove a majority of the members of the board of directors (or other governing body) as a result of binding arrangements (including existing legislation, regulation, contractual, or other arrangements).

Binding Arrangement with Other Vote Holders

AG39. A binding arrangement between an entity and other vote holders can give the entity the right to exercise voting rights sufficient to give the entity power, even if the entity does not have voting rights sufficient to give it power without the binding arrangement. However, a binding arrangement might ensure that the entity can direct enough other vote holders on how to vote to enable the entity to make decisions about the relevant activities.

Rights from Other Binding Arrangements and Legislative or Executive Authority

AG40. Other decision-making rights, in combination with voting rights, can give an entity the current ability to direct the relevant activities. For example, the rights specified in a binding arrangement and rights arising from legislative or executive authority in combination with voting rights may give an entity the current ability to direct the operating or financing policies or other key activities of another entity that significantly affect the benefits received by the entity. However, an entity would not control another entity if that other entity were able to determine its policy or program to a significant extent, (for example, by failing to comply with

the binding arrangement and accepting the consequences, or by changing its constitution or dissolving itself).

Economic Dependence

- AG41. Economic dependence, alone, does not give rise to power over an entity for the purposes of this Standard. Economic dependence may occur when:
- (a) An entity has a single major client and the loss of that client could affect the existence of the entity's operations; or
 - (b) An entity's activities are predominantly funded by grants and donations and it receives the majority of its funding from a single entity.
- AG42. An entity may be able to influence the financial and operating policies of another entity that is dependent on it for funding. However, a combination of factors will need to be considered to determine whether the economic dependence is such that the economically dependent entity no longer has the ultimate power to govern its own financial or operating policies. If an economically dependent entity retains discretion as to whether it will take funding from an entity, or do business with an entity, the economically dependent entity still has the ultimate power to govern its own financial or operating policies. For example, a private school that accepts funding from a government but whose governing body has retained discretion with respect to accepting funds or the manner in which those funds are to be used, would still have the ultimate power to govern its own financial or operating policies. This may be so even if government grants provided to such an entity requires it to comply with specified conditions. Although the entity might receive government grants for the construction of capital assets and operating costs subject to specified service standards or restrictions on user fees, its governing bodies may have ultimate discretion about how assets are used; the entity would therefore control its financial and operating policies. It is also important to distinguish between the operations of an entity and an entity itself. The loss of a major client might affect the viability of the operations of an entity but not the existence of the entity itself.

The Entity's Voting Rights

- AG43. An entity with less than a majority of the voting rights has rights that are sufficient to give it power when the entity has the practical ability to direct the relevant activities unilaterally.
- AG44. When assessing whether an entity's voting rights are sufficient to give it power, an entity considers all facts and circumstances, including:
- (a) The size of the entity's holding of voting rights relative to the size and dispersion of holdings of the other vote holders, noting that:
 - (i) The more voting rights an entity holds, the more likely the entity is to have existing rights that give it the current ability to direct the relevant activities;
 - (ii) The more voting rights an entity holds relative to other vote holders, the more likely the entity is to have existing rights that give it the current ability to direct the relevant activities;
 - (iii) The more parties that would need to act together to outvote the entity, the more likely the entity is to have existing rights that give it the current ability to direct the relevant activities;

- (b) Potential voting rights held by the entity, other vote holders or other parties (see paragraphs AG49–AG52);
- (c) Rights arising from other binding arrangements (see paragraph AG40); and
- (d) Any additional facts and circumstances that indicate the entity has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

- AG45. When the direction of relevant activities is determined by majority vote and an entity holds significantly more voting rights than any other vote holder or organized group of vote holders, and the other shareholdings are widely dispersed, it may be clear, after considering the factors listed in paragraph AG44(a)–(c) alone, that the entity has power over the other entity.
- AG46. In other situations, it may be clear after considering the factors listed in paragraph AG44(a)–(c) alone that an entity does not have power.
- AG47. However, the factors listed in paragraph AG44(a)–(c) alone may not be conclusive. If an entity, having considered those factors, is unclear whether it has power, it shall consider additional facts and circumstances, such as whether other shareholders are passive in nature as demonstrated by voting patterns at previous shareholders' meetings. This includes the assessment of the factors set out in paragraph AG20 and the indicators in paragraphs AG21–AG23. The fewer voting rights the entity holds, and the fewer parties that would need to act together to outvote the entity, the more reliance would be placed on the additional facts and circumstances to assess whether the entity's rights are sufficient to give it power. When the facts and circumstances in paragraphs AG20–AG23 are considered together with the entity's rights, greater weight shall be given to the evidence of power in paragraph AG20 than to the indicators of power in paragraphs AG21–AG23.
- AG48. If it is not clear, having considered the factors listed in paragraph AG44(a)–(d), that the entity has power, the entity does not control the other entity.

Potential Voting Rights

- AG49. When assessing control, an entity considers its potential voting rights as well as potential voting rights held by other parties, to determine whether it has power. Potential voting rights are rights to obtain voting rights of another entity, such as those arising from convertible instruments or options, including forward contracts. Those potential voting rights are considered only if the rights are substantive (see paragraphs AG25–AG28).
- AG50. When considering potential voting rights, an entity shall consider the purpose and design of the instrument, as well as the purpose and design of any other involvement the entity has with the other entity. This includes an assessment of the various terms and conditions of the instrument as well as the entity's apparent expectations, motives and reasons for agreeing to those terms and conditions.
- AG51. If the entity also has voting or other decision-making rights relating to the other entity's activities, the entity assesses whether those rights, in combination with potential voting rights, give the entity power.
- AG52. Substantive potential voting rights alone, or in combination with other rights, can give an entity the current ability to direct the relevant activities. For example, this is likely to be the case when an entity holds 40 per cent of the voting rights of another entity and, in

accordance with paragraph AG26, holds substantive rights arising from options to acquire a further 20 per cent of the voting rights.

Power when Voting or Similar Rights do not have a Significant Effect on Benefits

- AG53. In assessing the purpose and design of another entity (see paragraphs AG5–AG8), an entity shall consider the involvement and decisions made at the inception of the other entity as part of its design and evaluate whether the transaction terms and features of the involvement provide the entity with rights that are sufficient to give it power. Being involved in the design of another entity alone is not sufficient to give an entity control of that other entity. However, involvement in the design of the other entity may indicate that the entity had the opportunity to obtain rights that are sufficient to give it power over the other entity.
- AG54. In addition, an entity shall consider rights arising from binding arrangements such as call rights, put rights, liquidation rights and rights arising from legislative or executive authority established at the inception of the other entity. When binding arrangements involve activities that are closely related to the other entity, then these activities are, in substance, an integral part of the other entity's overall activities, even though they may occur outside the legal boundaries of the other entity. Therefore, explicit or implicit decision-making rights embedded in binding arrangements that are closely related to the other entity need to be considered as relevant activities when determining power over the other entity.
- AG55. For some other entities, relevant activities occur only when particular circumstances arise or events occur. The other entity may be designed so that the direction of its activities and the benefits from those activities are predetermined unless and until those particular circumstances arise or events occur. In this case, only the decisions about the other entity's activities when those circumstances or events occur can significantly affect its benefits and thus be relevant activities. The circumstances or events need not have occurred for an entity with the ability to make those decisions to have power. The fact that the right to make decisions is contingent on circumstances arising or an event occurring does not, in itself, make those rights protective.
- AG56. An entity may have an explicit or implicit commitment to ensure that another entity continues to operate as designed. Such a commitment may increase the entity's exposure to variability of benefits and thus increase the incentive for the entity to obtain rights sufficient to give it power. Therefore a commitment to ensure that another entity operates as designed may be an indicator that the entity has power, but does not, by itself, give an entity power, nor does it prevent another party from having power.

Exposure, or Rights, to Variable Benefits from another Entity

- AG57. When assessing whether an entity has control of another entity, the entity determines whether it is exposed, or has rights, to variable benefits from its involvement with the other entity.
- AG58. Variable benefits are benefits that are not fixed and have the potential to vary as a result of the performance of another entity. Variable benefits can be only positive, only negative or both positive and negative (see paragraph 26). An entity assesses whether benefits from another entity are variable and how variable those benefits are on the basis of the substance of the arrangement and regardless of the legal form of the benefits. For example:

- (a) In the context of non-financial benefits an entity may receive benefits as a result of the activities of another entity furthering its objectives. The benefits may be variable benefits for the purpose of this Standard because they may expose the entity to the performance risk of the other entity. If the other entity were unable to perform those activities then the entity might incur additional costs, either from undertaking the activities itself or by providing additional funds or other forms of assistance to enable the other entity to continue providing those activities.
- (b) In the context of financial benefits an entity can hold a bond with fixed interest payments. The fixed interest payments are variable benefits for the purpose of this Standard because they are subject to default risk and they expose the entity to the credit risk of the issuer of the bond. The amount of variability (i.e., how variable those benefits are) depends on the credit risk of the bond. Similarly, fixed performance fees for managing another entity's assets are variable benefits because they expose the entity to the performance risk of the other entity. The amount of variability depends on the other entity's ability to generate sufficient revenue to pay the fee.

Link between Power and Benefits

Delegated Power

AG59. It is common for public sector entities to be responsible for carrying out government policy. In some cases they may have the authority to act in their own right, in other cases they may act as agent for a Minister or another entity. For example:

- (a) A government department, which is authorized by a Minister to act on the Minister's behalf, might act solely as an agent of the responsible Minister in relation to another entity. In such cases the department would not control the other entity and would not consolidate it.
- (b) A government department may operate under a delegation of power from a Minister. The department uses its own discretion in making decisions and taking actions and is not subject to direction from the Minister. In such cases the department is acting in its own right and would need to apply the other requirements of this Standard to determine whether it controlled another entity. The scope of the department's decision-making authority over another entity would be a significant factor in distinguishing whether it is acting as an agent or as a principal.
- (c) An entity may establish a trust to carry out specified activities and appoints the trustee. The trustee is responsible for making decisions about the financing and operating activities of the trust in accordance with the trust deed. If the entity can replace the trustee at its discretion, the entity would need to assess whether it controls the trust given that, for example, it would be exposed, or have rights, to variable benefits in terms of the extent to which its objectives are achieved or furthered through the activities of the trust.

AG60. An entity may delegate its decision-making authority to an agent on some specific issues or on all relevant activities. When assessing whether it controls another entity, the entity shall treat the decision-making rights delegated to its agent as held by the entity directly. In situations where there is more than one principal, each of the principals shall assess whether it has power over the other entity by considering the requirements in paragraphs AG5–

AG56. Paragraphs AG61–AG73 provide guidance on determining whether a decision maker is an agent or a principal.

AG61. A decision maker shall consider the overall relationship between itself, the other entity being managed (and assessed for control) and other parties involved with that entity. In particular, a decision maker shall consider all the factors below, in determining whether it is an agent:

- (a) The scope of its decision-making authority over the other entity (paragraphs AG63 and AG64);
- (b) The rights held by other parties (paragraphs AG65–AG68);
- (c) The remuneration to which it is entitled in accordance with the remuneration agreement(s) (paragraphs AG69–AG71); and
- (d) The decision maker's exposure to variability of benefits from other interests that it holds in the other entity (paragraphs AG72 and AG73).

Different weightings shall be applied to each of the factors on the basis of particular facts and circumstances.

AG62. Determining whether a decision maker is an agent requires an evaluation of all the factors listed in paragraph AG61 unless a single party holds substantive rights to remove the decision maker (removal rights) and can remove the decision maker without cause (see paragraph AG66).

The Scope of the Decision-Making Authority

AG63. The scope of a decision maker's decision-making authority is evaluated by considering:

- (a) The activities that are permitted according to the decision-making agreement(s) and specified by law, and
- (b) The discretion that the decision maker has when making decisions about those activities.

AG64. A decision maker shall consider the purpose and design of the other entity, the risks to which the other entity was designed to be exposed, the risks it was designed to pass on to the parties involved and the level of involvement the decision maker had in the design of another entity. For example, if a decision maker is significantly involved in the design of the other entity (including in determining the scope of decision-making authority), that involvement may indicate that the decision maker had the opportunity and incentive to obtain rights that result in the decision maker having the ability to direct the relevant activities.

Rights held by Other Parties

AG65. Substantive rights held by other parties may affect the decision maker's ability to direct the relevant activities of another entity. Substantive removal or other rights may indicate that the decision maker is an agent.

AG66. When a single party holds substantive removal rights and can remove the decision maker without cause, this, in isolation, is sufficient to conclude that the decision maker is an agent. If more than one party holds such rights (and no individual party can remove the decision maker without the agreement of other parties) those rights are not, in isolation, conclusive in

determining that a decision maker acts primarily on behalf and for the benefit of others. In addition, the greater the number of parties required to act together to exercise rights to remove a decision maker and the greater the magnitude of, and variability associated with, the decision maker's other economic interests (i.e., remuneration and other interests), the less the weighting that shall be placed on this factor.

- AG67. Substantive rights held by other parties that restrict a decision maker's discretion shall be considered in a similar manner to removal rights when evaluating whether the decision maker is an agent. For example, a decision maker that is required to obtain approval from a small number of other parties for its actions is generally an agent. (See paragraphs AG25–AG28 for additional guidance on rights and whether they are substantive).
- AG68. Consideration of the rights held by other parties shall include an assessment of any rights exercisable by another entity's board of directors (or other governing body) and their effect on the decision-making authority (see paragraph AG26(b)).

Remuneration

- AG69. The greater the magnitude of, and variability associated with, the decision maker's remuneration relative to the benefits expected from the activities of the other entity, the more likely the decision maker is a principal.
- AG70. In determining whether it is a principal or an agent the decision maker shall also consider whether the remuneration agreement includes only terms, conditions or amounts that are customarily present in arrangements for similar services and level of skills negotiated on an arm's length basis.
- AG71. A decision maker cannot be an agent unless the conditions set out in paragraph AG72(a) and (b) are present. However, meeting those conditions in isolation is not sufficient to conclude that a decision maker is an agent.

Exposure to Variability of Benefits from Other Interests

- AG72. A decision maker that holds other interests in another entity (e.g., investments in the other entity or provides guarantees with respect to the performance of the other entity), shall consider its exposure to variability of benefits from those interests in assessing whether it is an agent. Holding other interests in another entity indicates that the decision maker may be a principal.
- AG73. In evaluating its exposure to variability of benefits from other interests in the other entity a decision maker shall consider the following:
- (a) The greater the magnitude of, and variability associated with, its economic interests, considering its remuneration and other interests in aggregate, the more likely the decision maker is a principal.
 - (b) Whether its exposure to variability of benefits is different from that of the other entities that receive benefits from the entity being assessed for control and, if so, whether this might influence its actions. For example, this might be the case when a decision maker holds subordinated interests in, or provides other forms of credit enhancement to, another entity.

The decision maker shall evaluate its exposure relative to the total variability of benefits of the other entity. This evaluation is made primarily on the basis of benefits expected from the activities of the other entity but shall not ignore the decision maker's maximum exposure to variability of benefits of the other entity through other interests that the decision maker holds.

Relationship with Other Parties

- AG74. When assessing control, an entity shall consider the nature of its relationship with other parties and whether those other parties are acting on the entity's behalf (i.e., they are "de facto agents"). The determination of whether other parties are acting as de facto agents requires judgment, considering not only the nature of the relationship but also how those parties interact with each other and the entity.
- AG75. Such a relationship need not involve a binding arrangement. Such relationships could also arise from legislative or executive authority. A party is a de facto agent when the entity has, or those that direct the activities of the entity have, the ability to direct that party to act on the entity's behalf. In these circumstances, the entity shall consider its de facto agent's decision-making rights and its indirect exposure, or rights, to variable benefits through the de facto agent together with its own when assessing control of another entity.
- AG76. The following are examples of such other parties that, by the nature of their relationship, might act as de facto agents for the entity:
- (a) The entity's related parties.
 - (b) A party that received its interest in the other entity as a contribution or loan from the entity making the assessment of control.
 - (c) A party that has agreed not to sell, transfer or encumber its interests in the other entity without the entity's prior approval (except for situations in which the entity and the other party have the right of prior approval and the rights are based on mutually agreed terms by willing independent parties).
 - (d) A party that cannot finance its operations without subordinated financial support from the entity.
 - (e) Another entity for which the majority of the members of its governing body or for which its key management personnel are the same as those of the entity.
 - (f) A party that has a close business relationship with the entity, such as the relationship between a professional service provider and one of its significant clients.

Control of Specified Assets

- AG77. An entity shall consider whether it treats a portion of another entity as a deemed separate entity and, if so, whether it controls the deemed separate entity.
- AG78. An entity shall treat a portion of another entity as a deemed separate entity if and only if the following condition is satisfied:
- Specified assets of the other entity (and related credit enhancements, if any) are the only source of payment for specified liabilities of, or specified other interests in, the other entity. Parties other than those with the specified liability do not have rights or obligations related to the specified assets or to residual cash flows from those assets. In substance, none of the benefits from the specified assets can be

used by the remaining portion of the other entity and none of the liabilities of the deemed separate entity are payable from the assets of the remainder of the other entity. Thus, in substance, all the assets, liabilities and equity instruments of that deemed separate entity are ring-fenced from the overall other entity. Such a deemed separate entity is often called a "silo".

- AG79. When the condition in paragraph AG78 is satisfied, an entity shall identify the activities that significantly affect the benefits of the deemed separate entity and how those activities are directed in order to assess whether it has power over that portion of the other entity. When assessing control of the deemed separate entity, the entity shall also consider whether it has exposure or rights to variable benefits from its involvement with that deemed separate entity and the ability to use its power over that portion of the other entity to affect the amount of the benefits from that entity.
- AG80. If the entity controls the deemed separate entity, the entity shall consolidate that portion of the other entity. In that case, other parties exclude that portion of the other entity when assessing control of, and in consolidating, the other entity.

Continuous Assessment

- AG81. An entity shall reassess whether it controls another entity if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 16.
- AG82. If there is a change in how power over another entity can be exercised, that change must be reflected in how an entity assesses its power over another entity. For example, changes to decision-making rights can mean that the relevant activities are no longer directed through voting rights, but instead other agreements, such as contracts, give another party or parties the current ability to direct the relevant activities.
- AG83. An event can cause an entity to gain or lose power over another entity without the entity being involved in that event. For example, an entity can gain power over another entity because decision-making rights held by another party or parties that previously prevented the entity from controlling another entity have lapsed.
- AG84. An entity also considers changes affecting its exposure, or rights, to variable benefits from its involvement with another entity. For example, an entity that has power over another entity can lose control of that other entity if the entity ceases to be entitled to receive benefits or to be exposed to obligations, because the entity would fail to satisfy paragraph 14(b) (e.g., if a contract to receive performance-related fees is terminated).
- AG85. An entity shall consider whether its assessment that it acts as an agent or a principal has changed. Changes in the overall relationship between the entity and other parties can mean that an entity no longer acts as an agent, even though it has previously acted as an agent, and vice versa. For example, if changes to the rights of the entity, or of other parties, occur, the entity shall reconsider its status as a principal or an agent.
- AG86. An entity's initial assessment of control or its status as a principal or an agent would not change simply because of a change in market conditions (e.g., a change in the other entity's benefits driven by market conditions), unless the change in market conditions changes one or more of the three elements of control listed in paragraph 16 or changes the overall relationship between a principal and an agent.

Determining Whether an Entity is an Investment Entity

AG87. An entity shall consider all facts and circumstances when assessing whether it is an investment entity, including its purpose and design. Paragraphs AG88–AG105 describe aspects of the definition of an investment entity in more detail.

Number of Investors

AG88. The definition of an investment entity requires that the entity have one or more investors. An investment entity may have several investors who pool their funds to gain access to investment management services and investment opportunities that they might not have had access to individually. Having several investors would make it less likely that the entity, or other members of the economic entity containing the entity, would obtain benefits other than capital appreciation or investment revenue.

AG89. However, in the public sector it is also common for an investment entity to be formed by, or for, a single controlling entity that represents or supports the interests of a wider group of investors (e.g., a pension fund, government investment fund or trust).

Ownership Interests

AG90. An investment entity is typically, but is not required to be, a separate legal entity. The investors in an investment entity will often, but not always, have ownership interests in the form of equity or similar interests (e.g., partnership interests), to which proportionate shares of the net assets of the investment entity are attributed. The definition of an investment entity does not specify that all investors must have the same rights. Having different classes of investors, some of which have rights only to a specific investment or groups of investments or which have different proportionate shares of the net assets, does not preclude an entity from being an investment entity.

AG91. The definition of an investment entity does not specify that the investors must have an ownership interest that meets the definition of net assets/equity in accordance with other applicable IPSASs. An entity that has significant ownership interests in the form of debt that does not meet the definition of net assets/equity may still qualify as an investment entity, provided that the debt holders are exposed to variable returns from changes in the fair value of the entity's net assets.

Purpose

AG92. The definition of an investment entity requires that the purpose of the entity is to invest solely for returns from capital appreciation, investment revenue (such as dividends or similar distributions, interest or rental revenue), or both. Documents that indicate what the entity's investment objectives are, such as the entity's mandate, constitution, offering memorandum, publications distributed by the entity and other corporate or partnership documents, will typically provide evidence of an investment entity's purpose. Further evidence may include the manner in which the entity presents itself to other parties; for example, an entity may present its objective as providing medium-term investment for capital appreciation.

AG93. An entity that has additional objectives that are inconsistent with the purpose of an investment entity would not meet the definition of an investment entity. Examples of when this may occur are as follows:

- (a) An investor whose objective is to jointly develop, produce or market products with its investees. The entity will earn returns from the development, production or marketing activity as well as from its investments;
- (b) An investor whose objectives require it to be aligned with the economic, social or environmental policies of another entity. For example, if an entity is required to align its investment policies with other objectives such as owning certain businesses or improving employment outcomes in a jurisdiction; and
- (c) An investor whose individual investment decisions have to be ratified or approved by a controlling entity or which is required to follow the direction of a controlling entity. Such ratifications, approvals or decisions are likely to be inconsistent with the purpose of an investment entity.

AG94. An entity's purpose may change over time. In assessing whether it continues to meet the definition of an investment entity, an entity would need to have regard to any changes in the environment in which it operates and the impact of such changes on its investment strategy.

Demonstrating Purpose through Holding More than One Investment

AG95. An investment entity may have a number of ways in which it can demonstrate that its purpose is to invest funds from capital appreciation, investment revenue or both. One way is by holding several investments to diversify its risk and maximize its returns. An entity may hold a portfolio of investments directly or indirectly, for example by holding a single investment in another investment entity that itself holds several investments.

AG96. There may be times when the entity holds a single investment. However, holding a single investment does not necessarily prevent an entity from meeting the definition of an investment entity. For example, an investment entity may hold only a single investment when the entity:

- (a) Is in its start-up period and has not yet identified suitable investments and, therefore, has not yet executed its investment plan to acquire several investments;
- (b) Has not yet made other investments to replace those it has disposed of;
- (c) Is established to pool investors' funds to invest in a single investment when that investment is unobtainable by individual investors (e.g., when the required minimum investment is too high for an individual investor); or
- (d) Is in the process of being disestablished.

Investment-related Services and Activities

AG97. An investment entity may provide investment-related services (e.g., investment advisory services, investment management, investment support and administrative services), either directly or through a controlled entity, to third parties as well as to its controlling entity or other investors, even if those activities are substantial to the entity.

AG98. An investment entity may also participate in the following investment-related activities, either directly or through a controlled entity, if these activities are undertaken to maximize the investment return (capital appreciation or investment revenue) from its investees and do not

represent a separate substantial activity or a separate substantial source of revenue to the investment entity:

- (a) Providing management services and strategic advice to an investee; and
- (b) Providing financial support to an investee, such as a loan, capital commitment or guarantee.

AG99. If an investment entity has a controlled entity that provides investment-related services or activities, such as those described in paragraphs AG97–AG98, to the entity or other parties, it shall consolidate that controlled entity in accordance with paragraph 53.

Exit Strategies

AG100. An entity's investment plans also provide evidence of its business purpose. One feature that differentiates an investment entity from other entities is that an investment entity does not plan to hold its investments indefinitely; it holds them for a limited period. Because equity investments and non-financial asset investments have the potential to be held indefinitely, an investment entity shall have an exit strategy documenting how the entity plans to realize capital appreciation from substantially all of its equity investments and non-financial asset investments. An investment entity shall also have an exit strategy for any debt instruments that have the potential to be held indefinitely, for example perpetual debt investments. The entity need not document specific exit strategies for each individual investment but shall identify different potential strategies for different types or portfolios of investments, including a substantive time frame for exiting the investments. Exit mechanisms that are only put in place for default events, such as a breach of contract or non-performance, are not considered exit strategies for the purpose of this assessment.

AG101. Exit strategies can vary by type of investment. For investments in private equity securities, examples of exit strategies include an initial public offering, a private placement, a trade sale of a business, distributions (to investors) of ownership interests in investees and sales of assets (including the sale of an investee's assets followed by a liquidation of the investee). For equity investments that are traded in a public market, examples of exit strategies include selling the investment in a private placement or in a public market. For real estate investments, an example of an exit strategy includes the sale of the real estate through specialized property dealers or the open market.

AG102. An investment entity may have an investment in another investment entity that is formed in connection with the entity for legal, regulatory, tax or similar business reasons. In this case, the investment entity investor need not have an exit strategy for that investment, provided that the investment entity investee has appropriate exit strategies for its investments.

Fair Value Measurement

AG103. An essential element of the definition of an investment entity is that it measures and evaluates the performance of substantially all of its investments on a fair value basis, because using fair value results in more relevant information than, for example, consolidating its controlled entities or using the equity method for its interests in associates or joint ventures. In order to demonstrate that it meets this element of the definition, an investment entity:

- (a) Provides investors with fair value information and measures substantially all of its investments at fair value in its financial statements whenever fair value is required or permitted in accordance with IPSASs; and
- (b) Reports fair value information internally to the entity's key management personnel (as defined in IPSAS 20, *Related Party Disclosures*), who use fair value as the primary measurement attribute to evaluate the performance of substantially all of its investments and to make investment decisions.

AG104. In order to meet the requirement in AG103(a), an investment entity would:

- (a) Elect to account for any investment property using the fair value model in IPSAS 16, *Investment Property*;
- (b) Elect the exemption from applying the equity method in IPSAS XX (ED 50) for its investments in associates and joint ventures; and refer to cost and equity method; and
- (c) Measure its financial assets at fair value using the requirements in IPSAS 29.

AG105. An investment entity may have some non-investment assets, such as a head office property and related equipment, and may also have financial liabilities. The fair value measurement element of the definition of an investment entity in paragraph 50(c) applies to an investment entity's investments. Accordingly, an investment entity need not measure its non-investment assets or its liabilities at fair value.

Appendix B

Amendments to Other IPSASs

IPSAS 1, *Presentation of Financial Statements*

Paragraphs 4, 12, 88(n), 95(d), 97, 103, 118 and 135 are amended and paragraph 153E added as follows:

4. This Standard applies equally to all entities including those that present consolidated financial statements in accordance with IPSAS XX (ED 49), *Consolidated Financial Statements* and those that present whether or not they need to prepare consolidated financial statements or separate financial statements, as defined in accordance with IPSAS XX (ED 48)6, *Consolidated and Separate Financial Statements*.
12. GBEs include both trading enterprises, such as utilities, and financial enterprises, such as financial institutions. GBEs are, in substance, no different from entities conducting similar activities in the private sector. GBEs generally operate to make a profit, although some may have limited community service obligations under which they are required to provide some individuals and organizations in the community with goods and services at either no charge or a significantly reduced charge. IPSAS XX (ED 49), *IPSAS-6* provides guidance on determining whether control exists for financial reporting purposes, and should be referred to in determining whether a GBE is controlled by another public sector entity.
88. **As a minimum, the face of the statement of financial position shall include line items that present the following amounts:**
 - (a) ...
 - (n) **Minority-Non-controlling interest, presented within net assets/equity; and**
95. **When an entity has no share capital, it shall disclose net assets/equity, either on the face of the statement of financial position or in the notes, showing separately:**
 - (a) ...
 - (d) **Minority-Non-controlling interests.**
97. In some cases, there may be a minority non-controlling interest in the net assets/equity of the entity. For example, at the whole-of-government level, the economic entity may include a GBE that has been partly privatized. Accordingly, there may be private shareholders who have a financial interest in the net assets/equity of the entity.
103. The following items shall be disclosed on the face of the statement of financial performance as allocations of surplus or deficit for the period:
 - (a) Surplus or deficit attributable to minority non-controlling interest; and
 - (b) Surplus or deficit attributable to owners of the controlling entity.

118. **An entity shall present a statement of changes in net assets/equity showing on the face of the statement:**

(a) ...

(c) **Total revenue and expense for the period (calculated as the sum of (a) and (b)), showing separately the total amounts attributable to owners of the controlling entity and to ~~minority~~ non-controlling interest; and**

135. Each entity considers the nature of its operations and the policies that the users of its financial statements would expect to be disclosed for that type of entity. For example, public sector entities would be expected to disclose an accounting policy for recognition of taxes, donations, and other forms of non-exchange revenue. When an entity has significant foreign operations or transactions in foreign currencies, disclosure of accounting policies for the recognition of foreign exchange gains and losses would be expected. When entity combinations have occurred, the policies used for measuring goodwill and ~~minority~~ non-controlling interest are disclosed.

153E. IPSAS XX (ED 49) and IPSAS XX (ED 52), *Disclosure of Interests in Other Entities*, issued in [Date], amended paragraphs 4, 12, 88(n), 95(d), 97, 103, 118, 134, 135 and 139. An entity shall apply those amendments when it applies IPSAS XX (ED 49), and IPSAS XX (ED 52).

In the Implementation Guidance that accompanies IPSAS 1, all references to “minority interest” are replaced with “non-controlling interest”.

IPSAS 2, *Cash Flow Statements*

Paragraph 30(b) is amended and paragraphs 50A, 52A, 52B and 63C are added as follows:

30. Under the indirect method, the net cash flow from operating activities is determined by adjusting surplus or deficit from ordinary activities for the effects of:

(a) ...

(b) Non-cash items such as depreciation, provisions, deferred taxes, unrealized foreign currency gains and losses, undistributed surpluses of associates, and ~~minority~~ non-controlling interests; and

50A An investment entity, as defined in IPSAS XX (ED 49), *Consolidated Financial Statements*, need not apply paragraphs 50(c) or 50(d) to an investment in a controlled entity that is required to be measured at fair value through surplus or deficit.

52A Cash flows arising from changes in ownership interests in a controlled entity that do not result in a loss of control shall be classified as cash flows from financing activities, unless the controlled entity is held by an investment entity, as defined in IPSAS XX (ED 49) and is required to be measured at fair value through surplus or deficit.

52B Changes in ownership interests in a controlled entity that do not result in a loss of control, such as the subsequent purchase or sale by a controlling entity of a controlled entity's equity instruments, are accounted for as equity transactions (see IPSAS XX (ED 49)), unless the controlled entity is held by an investment entity and is required to be measured at fair value through surplus or deficit. Accordingly, the resulting cash flows are classified in the same way as other transactions described in paragraph 26.

63C. IPSAS XX (ED 49) and IPSAS XX (ED 51), *Joint Arrangements*, issued in [Date], amended paragraph 30(b) and added paragraphs 52A and 52B. An entity shall apply those amendments when it applies IPSAS XX (ED 49) and IPSAS XX (ED 51).

IPSAS 4, *The Effects of Changes in Foreign Exchange Rates*

Paragraphs 22, 47, 51, 53 and 55 are amended and paragraph 71A is added as follows:

22. This Standard also permits a stand-alone entity preparing financial statements or an entity preparing separate financial statements in accordance with IPSAS XX (ED 48)6, *Consolidated and Separate Financial Statements*, to present its financial statements in any currency (or currencies). If the entity's presentation currency differs from its functional currency, its financial performance and financial position are also translated into the presentation currency in accordance with paragraphs 43–59.
47. The exchange differences referred to in paragraph 44(c) result from:
...
These exchange differences are not recognized in surplus or deficit because the changes in exchange rates have little or no direct effect on the present and future cash flows from operations. When the exchange differences relate to a foreign operation that is consolidated but is not wholly owned, accumulated exchange differences arising from translation and attributable to minority interests are allocated to, and recognized as part of, ~~minority~~ non-controlling interests in the consolidated statement of financial position.
51. The incorporation of the financial performance and financial position of a foreign operation with those of the reporting entity follows normal consolidation procedures, such as the elimination of balances and transactions within an economic entity (see ~~IPSAS 6~~ IPSAS XX (ED 49), *Consolidated Financial Statements* and IPSAS 8, *Interests in Joint Ventures*.)
53. When the financial statements of a foreign operation are as of a date different from that of the reporting entity, the foreign operation often prepares additional statements as of the same date as the reporting entity's financial statements. ~~When this is not done, IPSAS XX (ED 49) IPSAS 6 specifies requirements for when the reporting period of the controlling entity is different from that of a controlled entity allows the use of a different reporting date, provided that (a) the difference is no greater than three months, and (b) adjustments are made for the effects of any significant transactions or other events that occur between the different dates.~~
55. Adjustments are made for significant changes in exchange rates up to the reporting date of the reporting entity in accordance with IPSAS XX (ED 49) ~~IPSAS 6~~
- 71A. IPSAS XX (ED 49) and IPSAS XX (ED 51), *Joint Arrangements*, issued in [Date], amended paragraphs 22, 47, 51, 53 and 55. An entity shall apply those amendments when it applies IPSAS XX (ED 49) and IPSAS XX (ED 51).**

IPSAS 18, *Segment Reporting*

Paragraph 41 is amended as follows:

41. The financial statements for the whole-of-government, and certain other controlling entities, will require the consolidation of a number of separate entities such as departments, agencies, and GBEs. In preparing these consolidated financial statements, transactions and balances between controlled entities will be eliminated in accordance with IPSAS XX (ED 49), *Consolidated and Separate Financial Statements*. However, segment revenue, segment expense, segment assets, and segment liabilities are determined before balances and transactions between entities within the economic entity are eliminated as part of the consolidation process, except to the extent that such intra-economic entity balances and transactions are between entities within a single segment.

IPSAS 20, *Related Party Disclosures*

Paragraph 24 and 33 are amended and paragraph 42A added as follows:

24. Some IPSASs also require disclosure of transactions with related parties. For example, IPSAS 1 requires disclosure of amounts payable to and receivable from controlling entities, fellow controlled entities, associates, and other related parties. ~~IPSAS 6, *Consolidated and Separate Financial Statements*, and IPSAS 7 require disclosure of a list of significant controlled entities and associates.~~ IPSAS XX (ED 52), *Disclosure of Interests in Other Entities*, requires an entity to disclose information that enables users of its consolidated financial statements to understand the composition of the economic entity and information about each joint arrangement and associate that is material to the reporting entity.
33. Disclosure of related party transactions between members of an economic entity is unnecessary in consolidated financial statements, because consolidated financial statements present information about the controlling entity and controlled entities as a single reporting entity. Related party transactions that occur between entities within an economic entity, except for those between an investment entity and its controlled entities measured at fair value through surplus or deficit, are eliminated on consolidation in accordance with IPSAS XX (ED 49), *Consolidated Financial Statements* ~~IPSAS 6~~. Transactions with associated entities accounted for under the equity method are not eliminated, and therefore require separate disclosure as related party transactions.
- 42A. IPSAS XX (ED 49), IPSAS XX (ED 51), *Joint Arrangements* and IPSAS XX (ED 52) issued in [Date], amended paragraphs 24 and 33. An entity shall apply those amendments when it applies IPSAS XX (ED 49), IPSAS XX (ED 51), and IPSAS XX (ED 52).

Implementation Guidance

Amend the following note when it occurs (twice) in Implementation Guidance.

...

(Note: IPSAS XX (ED 52) ~~IPSAS 6, *Consolidated and Separate Financial Statements*~~, requires that certain disclosures be made about significant controlled entities.)

IPSAS 21, *Impairment of Non-Cash-Generating Assets***Paragraph 13 is amended as follows:**

13. Investments in:

- (a) Controlled entities, as defined in IPSAS XX (ED 49)6, *Consolidated and Separate Financial Statements*;

IPSAS 22, *Disclosure of Financial Information About the General Government Sector***Paragraphs 24, 26, 27, 29, 30 and BC9 are amended and paragraph 47A is added as follows:**

- 24. **In presenting financial information about the GGS, entities shall not apply the requirements of IPSAS XX (ED 49)6, *Consolidated and Separate Financial Statements*, in respect of entities in the PFCs and public NFCS sectors.**
- 26. This Standard reflects the view that the consolidated financial statements of a government that elects to disclose information about the GGS are to be disaggregated to present the GGS as one sector of the government reporting entity. Consistent with this view, this Standard requires that the same definitions and the same recognition, measurement, and presentation requirements that are applied when preparing the consolidated financial statements are also applied to the GGS disclosures, with one exception. That exception is that the requirements of IPSAS XX (ED 49)6 are not applied in respect of the relationship of the GGS sector with entities in the PFC and PNFC sectors.
- 27. IPSAS XX (ED 49)6 requires controlling entities to prepare financial statements that consolidate controlled entities on a line-by-line basis. IPSAS XX (ED 49)6 also contains (a) a detailed discussion of the concept of control as it applies in the public sector, and (b) guidance on determining whether control exists for financial reporting purposes. Consistent with the requirements of IPSAS XX (ED 49)6, entities in the PFC and PNFC sectors, as defined in statistical bases of financial reporting, that are controlled entities of the government will be consolidated in the government's financial statements.
- 29. To apply the IPSAS XX (ED 49)6 requirements for consolidation to the GGS would result in the representation of the consolidated financial statements of a government, rather than the GGS financial statements.
- 30. Therefore, in disclosing financial information about the GGS, balances and transactions between entities within the GGS are eliminated in accordance with IPSAS XX (ED 49)6. However, balances and transactions between entities in the GGS and entities in other sectors are not eliminated.
- 41. This Standard requires entities electing to disclose information about the GGS to disclose a list of the significant controlled entities that are included in the GGS. IPSAS XX (ED 49)6 requires entities preparing consolidated financial statements to disclose a list of the significant controlled entities that are included in the consolidated financial statements. Disclosure of which of the entities consolidated in the financial statements in accordance with IPSAS XX (ED 49)6 are included in the GGS will assist users in developing an understanding of the relationship between information about the government and its GGS, and in better understanding the GGS information itself.
- 47A. IPSAS XX (ED 49) issued in [Date], amended paragraphs 24, 26, 27, 29, 30, and 41. An entity shall apply those amendments when it applies IPSAS XX (ED 49).**

Basis for Conclusions

BC9. When GGS disclosures are made in financial statements, the requirements of IPSAS XX (ED 49)6 should not be applied in respect of PFCs and PNFCs. This is because the application of IPSAS XX (ED 49)6 to the PFC and PNFC sectors would result in the re-presentation of a government's consolidated financial statements rather than the GGS financial statements. This would defeat the purpose of the disclosure of GGS information as a bridge between financial statements prepared in accordance with IPSASs and those prepared in accordance with statistical bases of financial reporting.

IPSAS 24, *Presentation of Budget Information in Financial Statements*

In the Illustrative Examples that accompany IPSAS 24 all references to “minority interest” are replaced with “non-controlling interest”. They are also amended as follows:

Extract of Note Disclosures—for Government X

(Government X presents its approved budget on a cash basis and the financial statements on the accrual basis.)

1. The budget is approved on a cash basis by functional classification. The approved budget covers the fiscal period from January 1, 20XX to December 31, 20XX, and includes all entities within the general government sector. The general government sector includes all entities identified as government departments in note xx (prepared in accordance with IPSAS XX (ED 49)6, *Consolidated and Separate Financial Statements*).

IPSAS 26, *Impairment of Cash-Generating Assets*

Paragraph 12 is amended and paragraph 126D added as follows:

12. Investments in:
 - (a) Controlled entities, as defined in IPSAS XX (ED 49)6, *Consolidated and Separate Financial Statements*;
- 47A. IPSAS XX (ED 49) issued in [Date], amended paragraph 12. An entity shall apply that amendment when it applies IPSAS XX (ED 49).

IPSAS 28, *Financial Instruments: Presentation*

Paragraph 12 is amended and paragraph 60A added as follows:

3. An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard to all types of financial instruments except:
 - (a) Those interests in controlled entities, associates or joint ventures that are accounted for in accordance with IPSAS XX (ED 49), *Consolidated Financial Statements*, IPSAS XX (ED 48)6, *Consolidated and Separate Financial Statements*, or IPSAS XX (ED 50)7, *Investments in Associates and Joint Ventures*, or IPSAS 8, *Interests in Joint Ventures*. However, in some cases, IPSAS XX (ED 49), , IPSAS XX (ED 48)6, or IPSAS XX (ED 50)7, or IPSAS 8 require or permits an entity to account for an interest in a controlled entity, associate, or joint venture using IPSAS 29; in those cases, entities shall apply the requirements of this Standard. Entities shall also apply this Standard to all derivatives linked to interests in controlled entities, associates, or joint ventures.

60A. IPSAS XX (ED 49), and IPSAS XX (ED 51), *Joint Arrangements* issued in [Date], amended paragraph 3. An entity shall apply those amendments when it applies IPSAS XX (ED 49), and IPSAS XX (ED 51).

In the Appendix, paragraph AG53 is amended as follows:

- AG53. In consolidated financial statements, an entity presents non-controlling interests i.e., the interests of other parties in the net assets/equity and revenue of its controlled entities in accordance with IPSAS 1 and IPSAS XX (ED 49)6. When ...

IPSAS 29, *Financial Instruments: Recognition and Measurement*

Paragraphs 2(a), 17 and 89 are amended and paragraph 125B added as follows:

2. This Standard shall be applied by all entities to all types of financial instruments, except:
 - (a) Those interests in controlled entities, associates and joint ventures that are accounted for under in accordance with IPSAS XX (ED 49), *Consolidated Financial Statements*, IPSAS XX (ED 48)6, *Consolidated and Separate Financial Statements*, or IPSAS XX (ED 50)7, *Investments in Associates and Joint Ventures*, or IPSAS 8, *Interests in Joint Ventures*. However, in some cases, IPSAS XX (ED 49), IPSAS XX (ED 48)6, or IPSAS XX (ED 50)7, require or permit an entity to account for entities shall apply this Standard to an interest in a controlled entity, associate, or joint venture that according to IPSAS 6, IPSAS 7, or IPSAS 8 is accounted for under in accordance with some or all of the requirements of this Standard. ...
17. In consolidated financial statements, paragraphs 18–25 and Appendix A paragraphs AG49–AG67 are applied at a consolidated level. Hence, an entity first consolidates all controlled entities in accordance with IPSAS 6XX (ED 49) and the relevant international or national accounting standard or interpretation dealing with the consolidation of special purpose entities, and then applies paragraphs 18–25 and Appendix A paragraphs AG49–AG67 to the resulting economic entity.

89. For hedge accounting purposes, only assets, liabilities, firm commitments or highly probable forecast transactions that involve a party external to the entity can be designated as hedged items. It follows that hedge accounting can be applied to transactions between entities in the same economic entity only in the individual or separate financial statements of those entities and not in the consolidated financial statements of the economic entity except for the consolidated financial statements of an investment entity, as defined in IPSAS XX (ED 49), where transactions between an investment entity and its controlled entities measured at fair value through surplus or deficit will not be eliminated in the consolidated financial statements. As an exception, ...

125B. IPSAS XX (ED 49) and IPSAS XX (ED 51), Joint Arrangements, issued in [Date], amended paragraphs 2(a), 17, 89, AG2, AG14 and C2. An entity shall apply those amendments when it applies IPSAS XX (ED 49) and IPSAS XX (ED 51).

In Appendix A the flowchart following paragraph AG51 and paragraphs AG52–AG53 are amended as follows:

Consolidate all ~~controlled entities, (including any Special Purpose Entities)~~ [paragraph 17]

- AG52. The situation described in paragraph 20(b) (when an entity retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients) occurs, for example, if the entity is a ~~special purpose entity (SPE)~~ or trust, and issues to investors beneficial interests in the underlying financial assets that it owns and provides servicing of those financial assets. In that case, the financial assets qualify for derecognition if the conditions in paragraphs 21 and 22 are met.
- AG53. In applying paragraph 21, the entity could be, for example, the originator of the financial asset, or it could be an economic entity that includes a controlled entity ~~consolidated SPE~~ that has acquired the financial asset and passes on cash flows to unrelated third party investors.

In the Implementation Guidance examples F.1.4 and F.1.6 are amended as follows:

F.1.4 Internal Hedges

...

Yes, if the derivative contracts are internal to the entity being reported on. IPSAS 29 does not specify how an entity should manage its risk. However, it states that internal hedging transactions do not qualify for hedge accounting. This applies both (a) in consolidated financial statements for hedging transactions within an economic entity, and (b) in the individual or separate financial statements of a legal entity for hedging transactions between divisions in the entity. The principles of preparing consolidated financial statements in ~~IPSAS 6.49~~ IPSAS XX (ED 49) paragraph 21.1 requires that “Balances, transactions, revenue and expenses within the economic entity shall be eliminated in full.” a controlling entity “Eliminate in full intra-economic entity assets and liabilities, net assets/equity, revenue, expenses and cash flows relating to transactions between entities of the economic entity”.

F.1.6 Offsetting Internal Derivative Contracts Used to Manage Foreign Currency Risk

...

It depends. IPSAS XX (ED 49)6, ~~Consolidated and Separate Financial Statements~~ requires all internal transactions to be eliminated in consolidated financial statements. As stated in IPSAS 29.82, internal hedging transactions do not qualify for hedge accounting in the consolidated financial statements of the economic entity. Therefore, if an entity wishes to achieve hedge accounting in the consolidated financial statements, it must designate a hedging relationship between a qualifying external hedging instrument and a qualifying hedged item.

In the Basis for Conclusions, paragraph BC4 is footnoted as follows

In [Date] the IPSASB introduced the concept of investment entities in IPSAS XX (ED 49) and required investment entities, as defined in that Standard, to measure their investments in controlled entities, other than those providing investment-related services or activities, at fair value through surplus or deficit.

IPSAS 30, *Financial Instruments: Disclosures*

Paragraph 3(a) is amended and paragraph 52A added as follows:

3. This Standard shall be applied by all entities to all types of financial instruments, except:
 - (a) Those interests in controlled entities, associates, or joint ventures that are accounted for in accordance with IPSAS XX (ED 49), *Consolidated Financial Statements*, IPSAS XX (ED 48)6, ~~Consolidated and Separate Financial Statements~~, or IPSAS XX (ED 50)7, *Investments in Associates and Joint Ventures*, ~~or IPSAS 8, *Interests in Joint Ventures*~~. However, in some cases, IPSAS XX (ED 49), IPSAS XX (ED 48)6, or IPSAS XX (ED 50)7, or IPSAS 8 require or permits an entity to account for an interest in a controlled entity, associate, or joint venture using IPSAS 29; in those cases

52A. IPSAS XX (ED 49) and IPSAS XX (ED 51), *Joint Arrangements*, issued in [Date], amended paragraph 3(a). An entity shall apply that amendment when it applies IPSAS XX (ED 49), and IPSAS XX (ED 51).

IPSAS 31, *Intangible Assets*

Paragraph 6(d) is amended and paragraph 132A added as follows:

6. If another IPSAS prescribes the accounting for a specific type of intangible asset, an entity applies that IPSAS instead of this Standard. For example, this Standard does not apply to:
 - (a) ...
 - (d) Financial assets as defined in IPSAS 28. The recognition and measurement of some financial assets are covered by IPSAS XX (ED 49), *Consolidated Financial Statements*, IPSAS XX (ED 48)6, ~~Consolidated and Separate Financial Statements~~, and IPSAS XX (ED 50)7, *Investments in Associates and Joint Ventures*, ~~and IPSAS 8, *Interests in Joint Ventures*~~; and....

132A. IPSAS XX (ED 49) and IPSAS XX (ED 51), *Joint Arrangements* issued in [Date], amended paragraph 6(d). An entity shall apply that amendment when it applies IPSAS XX (ED 49), and IPSAS XX (ED 51).

IPSAS 32, *Service Concession Arrangements: Grantor*

Paragraphs BC33(d) and BC349(d) are amended as follows:

BC33. Some respondents to ED 43 indicated that the credit should be treated as net assets/equity, consistent with IPSAS 1, which defines net assets/equity as the residual interest in the assets of the entity after deducting all its liabilities. IPSAS 1 envisages four components of net assets/equity. Those components include:

(a) ...

(d) ~~Minority~~ Non-controlling interests.

BC34. The IPSASB concluded that the credit did not represent a direct increase in the grantor's net assets/equity because the credit is not one of the components of net assets/equity identified in paragraph BC33 for the reasons noted below:

(a) ...

(d) A ~~minority~~ non-controlling interest is defined as "that portion of the surplus or deficit and net assets/equity of a controlled entity attributable to net assets/equity interests that are not owned, directly or indirectly, through controlled entities, by the controlling entity." A ~~minority~~ non-controlling interest may arise,

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS XX (ED 49), Consolidated Financial Statements.

Objective

- BC1. This Basis for Conclusions summarizes the IPSASB's considerations in reaching the conclusions in IPSAS XX (ED 49). As this Standard is based on IFRS 10, *Consolidated Financial Statements* issued by the IASB, the Basis for Conclusions outlines only those areas where IPSAS XX (ED 49), departs from the main requirements of IFRS 10, or where the IPSASB considered such departures.

Process

- BC2. In developing the Standard the IPSASB had regard to those aspects of IPSAS 6 that had been developed specially to address public sector issues or circumstances that are more prevalent in the public sector than in other sectors. The IPSASB focused on addressing these issues in the Standard. The IPSASB also had regard to the guidance on assessing whether an entity is controlled for the purposes of *Government Finance Statistics Manual 2013* (GFSM 2013) with the aim of avoiding unnecessary differences. In developing additional examples that illustrated the public sector environment the IPSASB also considered guidance developed, or in the process of being developed, by national standard setters (for example, the Australian Accounting Standards Board).

Scope (paragraphs 5–9)

Wholly and Partly Owned Controlling Entities

- BC3. The IPSASB agreed that, consistent with the requirements in IPSAS 6 (December 2006) and IFRS 10, wholly or partly owned controlling entities that meet certain conditions, and post-employment or other long-term employee benefit plans should not be required to present consolidated financial statements. The IPSASB decided that a controlling entity which itself is a controlled entity should not be required to present consolidated financial statements only if “users of such financial statements are unlikely to exist or their information needs are met by the controlling entity's consolidated financial statements”. This limitation is intended to protect users where such controlling entities represent key sectors or activities of a government and there are users that need consolidated financial statements for accountability or decision making purposes.

Application of the Consolidation Requirements to all Controlled Entities

- BC4. The IPSASB noted the general principle in both IFRS 10 and IPSAS 6 (December 2006) that a controlling entity should consolidate, on a line by line basis, all of its controlled entities. The IPSASB noted that over recent years the potential scale and complexity of a public sector entity's involvement with other entities (particularly the relationships between a government and other entities) had increased. Government interventions had been a contributing factor to governments (and other public sector entities) having a broad range of interests in other entities, some of which could give rise to control as defined in the proposed Standard. The implications of consolidation when a government has a large number of controlled entities, controlled entities carrying out activities that were formerly regarded as solely private sector

activities, and controlled entities where control is intended to be temporary, had led some to query whether consolidation of all controlled entities was justified, having regard to the costs and benefits of doing so.

BC5. The IPSASB deliberated extensively on the issue of whether all controlled entities should be consolidated, having regard to users' needs. The IPSASB focused on the information provided by consolidated financial statements, whilst noting that users' information needs may also be met through other statements and reports such as (i) separate financial statements of both controlling and controlled entities; (ii) performance reports; and (iii) statistical reports. Although some of the IPSASB's discussions were relevant to any type of public sector entity that is a controlling entity, many of the matters considered were more pertinent at the whole of government level. The IPSASB considered views on the usefulness of consolidation in relation to the following types of controlled entities (whilst noting that these broad categories would not be universally applicable):

- (a) Departments and ministries;
- (b) Government agencies;
- (c) Government Business Enterprises (GBE);
- (d) Financial institutions (excluding government sponsored enterprises); and
- (e) Other investments (including intentional investments, incidental investments and investment entities). The term "incidental investments" was used to refer to interests acquired in the course of meeting another objective, such as preventing the collapse of a private sector entity.

BC6. The IPSASB noted that, although there was general agreement that consolidation of controlled departments and ministries and government agencies is appropriate, some members were less certain that the cost of preparing consolidated financial information was justified for other categories of controlled entities.

BC7. The IPSASB noted arguments in support of requiring consolidation of all controlled entities of a government, including the following:

- (a) Consolidated financial statements provide a panoramic view of a government's activities and current financial position. This panoramic view ensures that users do not lose sight of the risks associated with certain sectors. It shows the performance of the government as a whole.
- (b) Identifying categories of entities which should not be consolidated could be difficult. Such attempts could lead to rules-based standards. For example, there could be difficulties in separately identifying entities rescued from financial distress on a consistent basis across jurisdictions and over time. Similar issues could arise in respect of any separate proposals for GBEs. Although the term GBE is a defined term within IPSASs, the IPSASB noted that there are differences in the way this definition is being applied in practice in different jurisdictions. In addition to the issue of clearly identifying any group of entities for which different accounting requirements would be appropriate, the IPSASB noted that similar activities can be conducted by a variety of entity types both within and across jurisdictions. So, although proposals for different accounting

treatments might lead to consistent treatment for a group of entities within a jurisdiction, it might not result in comparable accounting for similar activities.

- (c) Consolidation of all controlled entities is an example of like items being accounted for in like ways. Exceptions to consolidation reduce the coherence of the financial statements. Given that there could be a number of entities that could potentially be regarded as warranting separate treatment or disclosure, this could adversely affect the coherence of consolidated financial statements.
- (d) Whole of government financial statements have a different perspective from separate financial statements. Separate financial statements provide information on the activities of the core government.

BC8. The IPSASB also noted arguments that have been raised in opposition to consolidation of certain controlled entities of a government, including the following:

- (a) The consolidation of entities that have activities that differ from the activities of the core government could obscure the presentation of the results and the condition of the government itself. This argument was raised in relation to a variety of controlled entities including manufacturing activities, large financial institutions, temporarily controlled entities and entities with financial objectives as opposed to social objectives.
- (b) Some consider that equity accounting for certain categories of controlled entities provides appropriate information on financial performance subsequent to acquisition without incurring high costs or obscuring information about the core government.
- (c) Some consider that it is inappropriate to consolidate entities that have been rescued from financial distress because they do not represent core government activities and are not intended to be long-term investments.
- (d) Where governments have high numbers of controlled entities the costs of the consolidation process are high and may be perceived to outweigh the benefits of consolidating those entities on a line by line basis.

BC9. Reflecting on these arguments for and against requiring consolidation of all controlled entities the IPSASB had regard to:

- (a) The objectives of financial reporting, as outlined in *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (the Conceptual Framework)*;
- (b) The limited availability of evidence on user needs and usefulness of consolidated financial information (particularly on the usefulness of consolidated financial information in respect of specific types of controlled entities);
- (c) The context within which whole of government consolidated financial statements are prepared;
- (d) The interaction between the definition of control and the consolidation requirements in the proposed Standard; and
- (e) The IPSASB's role as an international accounting standard setter.

BC10. With regard to the objectives of financial reporting, the IPSASB noted that Chapter 2 of the *Conceptual Framework* identifies the objectives of financial reporting as being to provide

information that is useful for accountability purposes and for decision-making purposes. Because of the importance of the budget in the public sector (and the importance of demonstrating compliance with the budget) the IPSASB considered an argument that consolidated financial statements should consolidate only those entities that comprise a government's budget entity. However, the IPSASB agreed that a budget entity approach would not be appropriate for general purpose financial reporting because:

- (a) Decisions about which entities are included in a government's budget may be based on factors other than the degree of autonomy of the entity and the extent to which it provides market goods or makes a commercial return.
- (b) Decisions about which entities are included in a government's budget are often related to whether the entity's activity is intended to be self-funding. The exclusion of self-funding entities from a government's budget, essentially allows the offsetting of revenue and expenses for those activities and means that budget sector information does not reflect the substance of all transactions controlled by a government.
- (c) The budget boundary for a jurisdiction is determined within a jurisdiction. If financial reporting were based on budget sectors there would not be standardized and comparable financial reporting by governments in an international context.

BC11. IPSAS 6 (December 2006) 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 acquisition and (b) management was actively seeking a buyer. Such temporarily controlled entities were required to be accounted for as financial instruments. The IPSASB considered whether this treatment of temporarily controlled entities should also be required in the proposed Standard. The IPSASB noted a number of concerns regarding the requirements in IPSAS 6 (December 2006). These included:

- (a) The difficulty of identifying temporarily controlled entities;
- (b) The difficulty of justifying a different accounting treatment for controlled entities that are held for more than a couple of years (which can occur with some entities that are initially considered to be temporarily controlled);
- (c) The difficulty of disposing of an investment in its current form. A public sector entity may need to retain responsibility for certain risks in order to dispose of its investment in a temporarily controlled entity. Accounting for such entities as financial instruments provides only a partial representation of the risks associated with the investment;
- (d) If a public sector entity is exposed to risks from an investment in a "temporarily" controlled entity these risks should be reported consistently with the risk exposures from other controlled entities; and
- (e) The provision of additional explanations by the reporting entity can address some of the issues that arise when large temporarily controlled entities are consolidated.

BC12. The IPSASB therefore decided not to require a different accounting treatment for temporarily controlled entities.

BC13. In considering the existence of research regarding the usefulness of consolidated financial statements in meeting user needs, the IPSASB noted that although an increasing number of

governments are applying the accrual basis of accounting, this has been a relatively recent trend and consolidation is often implemented in stages, with core government activities being consolidated first, followed by the consolidation of other categories of entities as time and resources permit. As a result, there are few jurisdictions that currently present consolidated whole of government financial statements, and empirical research on the usefulness of consolidated whole of government financial statements has been limited. Research to date has tended to focus on who uses consolidated financial statements and the overall benefits of consolidated financial statements, as opposed to the usefulness of consolidating certain types of controlled entities or accounting for them in an alternative way.

- BC14. The IPSASB noted that in developing its requirements for investment entities the IASB focused on user needs. Matters considered by the IPSASB in relation to investment entities are discussed later in this Basis for Conclusions.
- BC15. The IPSASB noted that many governments prepared statistical reports which present consolidated financial information in a sectoral approach, breaking down between the general government sectors and public corporation sectors (Non-Financial and Financial). This information is compiled in accordance with statistical guidance in the System of National Accounts (SNA 2008), that is consistent with guidance in the GFSM 2013 and ESA 2010. The IPSASB considered whether such a statistical approach could be considered as an alternative to the compilation of whole of government accounts based on the IPSAS approach. The IPSASB noted that IPSAS 22, *Disclosure of Financial Information about the General Government Sector* provides guidance on the presentation of such statistical information in consolidated financial statements. However, IPSAS 22 neither requires the provision of such information in consolidated financial statements, nor permits the presentation of such information as an alternative to consolidation of all controlled entities. Although the IPSASB noted that statistical reporting serves an important role and provides information that is comparable across countries, the IPSASB agreed that such information had a different objective and did not fulfill the role of consolidated financial statements in giving an overview of all government activity. The IPSASB also noted that mandating the provision of statistical sector information by governments other than national governments could be difficult. The IPSASB therefore agreed that any changes to IPSAS 22 should not form part of its project to update IPSASs 6 to 8.
- BC16. Having taken all these factors into consideration in the development of the proposed Standard, the IPSASB agreed to propose the consolidation of all controlled entities, other than the exception(s) from consolidation relating to investment entities (discussed separately in this Basis for Conclusions). The IPSASB also agreed to seek the views of constituents as to whether there are any categories of entities that should not be consolidated, with any proposals for non-consolidation being justified having regard to user needs.

Investment Entities

- BC17. In October 2012 the IASB issued *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27). As a result of these amendments IFRS 10 requires that a controlling entity that is an investment entity account for most of its investments at fair value through profit or loss, as opposed to consolidating them. The IPSASB considered the appropriateness of the requirements in IFRS 10 for similar entities in the public sector. The IPSASB first considered which entities might be affected by such requirements. Entities that might meet the definition

of an investment entity include some sovereign wealth funds, some pension funds and some funds holding controlling interests in public-private partnership projects (PPP) or private finance initiatives (PFI). The IPSASB noted that any requirements applicable only to investment entities might apply to a relatively small number of public sector entities (having regard to the types of entities that might be investment entities and the fact that these entities might be required to report in accordance with a range of accounting standards, including domestic standards).

- BC18. The IPSASB noted the comments made by respondents to the IASB in relation to the IASB's investment entity proposals and considered that similar arguments would apply in the public sector. Indeed, the IPSASB noted that some types of entities specifically identified by the IASB as potential investment entities (for example, sovereign wealth funds) could be public sector entities applying IPSASs. The IPSASB noted the IASB's focus on user needs in the IASB's deliberations on investment entities. The IPSASB noted that, depending on the reporting framework of the jurisdiction in which they operate, a public sector investment entity might be required to report in accordance with IPSASs, IFRSs, or domestic standards. The IPSASB agreed that the IFRS 10 requirement for an investment entity to account for its investments at fair value appeared to be appropriate in the public sector. The IPSASB also noted that consistent requirements in IPSASs and IFRSs would reduce any opportunity for accounting arbitrage when determining which accounting standards an investment entity should be required to apply.
- BC19. The IPSASB considered whether the definition of an investment entity in IFRS 10 was appropriate in the public sector. The IPSASB agreed that the definition was largely appropriate although it noted that an investment entity will frequently have an external mandate that establishes its purpose (as opposed to the entity asserting its purpose to investors) and amended the definition accordingly. The IPSASB considered that it would be helpful to give additional public sector examples of scenarios in which an entity would not be an investment entity by virtue of having additional objectives.
- BC20. The IPSASB considered whether the typical characteristics of an investment entity were appropriate for application in the public sector. The IPSASB noted that IFRS 10 allows for the possibility that an entity may be an investment entity, despite not meeting all the typical characteristics. In such cases the entity is required to explain why it is an investment entity, despite not having all of the typical characteristics of an investment entity. The IPSASB considered that the typical characteristics identified in IFRS 10 were not likely to be typical characteristics in the public sector context. For example, a sovereign wealth fund might:
- (a) Have a single investor (being a Minister or a public sector entity). The fund could argue that it is investing funds on behalf of, or for the benefit of, citizens. Indeed, IFRS 10, paragraph BC259 explicitly refers to government-owned investment funds and funds wholly owned by pension plans and endowments when explaining why the IASB decided to make this a typical characteristic rather than an essential part of the definition of an investment entity.
 - (b) Have investors that are related parties. A fund with a related party investor could nevertheless be acting on behalf of many unrelated beneficiary investors.
 - (c) Have ownership interests in a form other than equity or similar interests. The IPSASB noted both that the form of ownership interests in sovereign wealth funds could vary,

and that IFRS 10, paragraph BC264, specifically refers to pension funds and sovereign wealth funds when explaining why the IASB decided to make this a typical characteristic rather than an essential part of the definition. IFRS 10, paragraph BC264 states “For example, a pension fund or sovereign wealth fund with a single direct investor may have beneficiaries that are entitled to the net assets of the investment fund, but do not have ownership units.

- BC21. Because of the differences between the private and public sector, the IPSASB decided not to identify typical characteristics separately from the definition of an investment entity. The IPSASB noted that much of the discussion in IFRS 10 regarding the typical characteristics of investment entities described ways in which an entity could demonstrate that it met the definition of an investment entity. The IPSASB therefore decided to retain such guidance, but to locate it together with other guidance on the definition of an investment entity. The IPSASB agreed that the characteristic in IFRS 10 that “The individuals or entities that have provided funds to the entity are not related parties of the entity” did not reflect the public sector context and agreed to omit the guidance on that characteristic.
- BC22. Although the IPSASB decided not to identify typical characteristics separately from the definition of an investment entity, the IPSASB considered that most public sector entities classifying themselves as investment entities should be required to disclose information about the judgments and assumptions made. The IPSASB considered that disclosure of these judgments and assumptions would be important for transparency and encourage appropriate use of the investment entity accounting requirements.
- BC23. The IPSASB noted that in comparison with private sector entities which tend to have clear financial objectives, public sector entities can have a broader range of objectives, and these objectives can change over time. A public sector entity’s objectives may also change as a result of changes in government policy and changes could lead to an entity that had formerly met the definition of an investment entity ceasing to do so. Having regard to the possibility of changing objectives the IPSASB therefore agreed to highlight the need for an entity to reassess its status on a regular basis.
- BC24. The IPSASB noted that the IFRS 10 investment entity requirements apply to the financial statements of an investment entity itself – they cannot be applied by the controlling entity of any investment entity. IFRS 10 requires that a controlling entity that is not itself an investment entity shall present consolidated financial statements in which all controlled entities are consolidated on a line by line basis. The IPSASB considered whether the public sector context would lead it to place more or less weight on arguments considered by the IASB in relation to this matter, and whether there were any public sector characteristics that would support a differing accounting treatment by the controlling entity of an investment entity.
- BC25. 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.

- BC26. 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.

Control (paragraphs 14–33)

- BC27. The IPSASB agreed that the three requirements for control outlined in IFRS 10 are generally appropriate for the public sector. The IPSASB noted that the IFRS 10 requirements to have power, returns and a link between power and returns is similar to the approach previously taken by the IPSASB in IPSAS 6 (December 2006), although IPSAS 6 (December 2006) required that both power and benefits be present. Consistent with the terminology used in IPSAS 6 (December 2006) the IPSASB decided that the term "benefits" was more appropriate than "returns" in the public sector context (as discussed under the subheading "Terminology" below).
- BC28. The IPSASB took note of the approach taken in Government Finance Statistics in relation to control over an entity. The System of National Accounts (SNA 2008, paragraph 4.80) includes eight indicators of control of corporations and five indicators of control of nonprofit institutions and explains that "Although a single indicator could be sufficient to establish control, in other cases a number of indicators may collectively indicate control". Overall, the direction of the statistical indicators is on the same lines as the approach in this Standard and therefore the practical results of the respective analyses will likely largely coincide. Some of the indicators in GFS are mentioned in the following paragraphs.

Power (paragraphs 19–25)

- BC29. The IPSASB decided to modify IFRS 10 to:
- (a) Highlight the range of relevant activities that could occur in the public sector and stress that control of financial and operating policies can demonstrate power over relevant activities;
 - (b) Clarify that regulatory control and economic dependence do not give rise to power for the purposes of the Standard; and
 - (c) Discuss specific powers that could give rise to control in the public sector, including golden shares, a right to appoint the majority of the board of another entity, and powers obtained through legislation or enabling documents.

Regulatory Control

- BC30. The IPSASB agreed that the previous guidance on regulatory control in IPSAS 6 (December 2006) should be incorporated in the Standard. The IPSASB noted that IFRS 10 had been developed for application by profit-oriented entities, few of whom have powers to create or enforce legislation or regulations. By contrast, the nature of government means that regulatory power occurs frequently in the public sector.
- BC31. In considering how to incorporate guidance on regulatory control in the Standard the IPSASB noted that (i) the discussion of power in IFRS 10 focuses on the ability to influence the “relevant activities” of the investee, and (ii) power is only one of the three elements that are required for control to exist. The IPSASB decided to place the discussion of regulatory control alongside the discussion of power and relevant activities.
- BC32. The IPSASB noted that the discussion of regulation and control in the SNA 2008 is similar to that previously in IPSAS 6. The SNA 2008 states:

Regulation and control. The borderline between regulation that applies to all entities within a class or industry group and the control of an individual corporation can be difficult to judge. There are many examples of government involvement through regulation, particularly in areas such as monopolies and privatized utilities. It is possible for regulatory involvement to exist in important areas, such as in price setting, without the entity ceding control of its general corporate policy. Choosing to enter into or continue to operate in a highly regulated environment suggests that the entity is not subject to control. When regulation is so tight as to effectively dictate how the entity performs its business, then it could be a form of control. If an entity retains unilateral discretion as to whether it will take funding from, interact commercially with, or otherwise deal with a public sector entity, the entity has the ultimate ability to determine its own corporate policy and is not controlled by the public sector entity.

- BC33. The IPSASB noted that the SNA 2008 discusses control by a dominant customer. The SNA 2008 states:

"In general, if there is clear evidence that the corporation could not choose to deal with non-public sector clients because of public sector influence, then public control is implied."

Economic Dependence

- BC34. IFRS 10 paragraph AG40 states that “In the absence of any other rights, economic dependence of an investee on the investor (such as relations of a supplier with its main customer) does not lead to the investor having power over the investee.” Although the IPSASB agreed that economic dependence, on its own, does not give rise to control, the IPSASB noted that, in the public sector, economic dependence may occur in conjunction with other rights. These other rights need to be assessed to determine if they give rise to control.
- BC35. Because of the prevalence of economic dependence in the public sector the IPSASB decided that it was appropriate to discuss ways in which economic dependence can arise and include examples of economic dependence.

Special Voting Rights Attaching to Ownership Interests (Golden Shares)

- BC36. The IPSASB agreed that the Standard should acknowledge that special voting rights attaching to ownership interests (often referred to as “golden shares”) will influence

assessments of control. The IPSASB noted that such rights are also acknowledged in the GFSM 2013.

Substantive Rights

- BC37. Statutory independence is common in the public sector. The IPSASB agreed to illustrate the ways in which statutory independence may influence an investor's assessments of rights. The Standard notes that the existence of statutory independence of an investee could be seen as a barrier to the investor exercising its rights (paragraph AG26). It also notes that the existence of statutory powers to operate independently does not, of itself, preclude an entity from being controlled by another entity (paragraph 19).

Terminology

- BC38. In addition to making changes to reflect the standard terminology in IPSASs, the IPSASB agreed that a number of other changes to the terminology in IFRS 10 were appropriate.

Investor/Investee

- BC39. IFRS 10 uses the terms "investor" and "investee" to denote (i) the potential controlling entity, being the entity that is applying the Standard to assess whether control exists and (ii) the potential controlled entity. The IPSASB considered that these terms were inappropriate in most parts of this Standard because they could be read as implying the existence of a financial instrument representing an ownership interest. Most assessments of control in the public sector do not involve such financial instruments.
- BC40. The IPSASB considered other terms that could be used to describe investors and investees, in the context of the Standard. One option was to refer to an investor as a "potential controlling entity" and an investee as a "potential controlled entity". The IPSASB considered that these phrases, whilst clear in meaning, would be cumbersome to use throughout the Standard. The IPSASB noted that IPSASs generally refer to the entity applying the Standard as "the entity". In the case of this Standard, the entity applying the Standard is the entity that is assessing whether or not it controls another entity (referred to as the investor in IFRS 10). The entity applying the Standard is doing so in order to determine whether it controls another entity. The IPSASB therefore decided that, depending on the context, it would refer to the investor as "the entity" and the investee as "another entity", "other entity", or "entity being assessed for control".
- BC41. The IPSASB agreed to retain use of the term "investors" where the Standard is referring to a specific investment and the term is used in accordance with its usual meaning. This was particularly relevant in the parts of the Standard dealing with investment entities.
- BC42. The IPSASB also agreed that the terms "investor" and "investee" are appropriate when referring to interests in joint ventures and associates.

Binding Arrangements

- BC43. The IPSASB agreed to replace references to "contractual arrangements" with reference to the term "binding arrangements". This change acknowledges that in some jurisdictions, entities applying IPSASs may not have the power to enter into contracts but nevertheless may have the authority to enter into binding arrangements. In addition, the IPSASB agreed

that binding arrangements, for the purpose of this Standard, should encompass rights that arise from legislative or executive authority.

Benefits

- BC44. The IPSASB agreed that the term “benefits” is more appropriate than the term “returns” in the public sector, particularly given the existence of control relationships in the absence of a financial investment in the controlled entity. The IPSASB considered that the term “returns” could be regarded as giving an inappropriate emphasis to financial returns, whereas, in the public sector, benefits are more likely to be non-financial than financial.
- BC45. The IPSASB decided to modify IFRS 10 to:
- (a) Highlight that many assessments of control in the public sector involve assessments of non-financial benefits;
 - (b) Note that benefits can have positive or negative aspects; and
 - (c) Include examples of benefits in a public sector context.
- BC46. The IPSASB agreed to locate the examples of benefits in the body of the Standard as it considered that the examples would be particularly useful for an entity making an initial assessment of whether it might control other entities.
- BC47. The definition of control in IPSAS XX (ED 49) refers to “variable benefits” and this concept is referred to throughout the Standard. The IPSASB considered how the Standard would apply to benefits that appeared to be fixed or constant. The IPSASB noted that the IASB had explicitly considered this issue and had provided examples to show that benefits that appear to be fixed could in fact be variable, because they exposed the entity to performance risk. The IPSASB noted that the IASB examples related to financial benefits and agreed to incorporate an example of a non-financial benefit in paragraph AG58.

Alternative View of Mr. Bob Dacey

This exposure draft proposes to withdraw the current exemption in IPSAS 6 for temporarily controlled entities. This member believes that certain entities that are temporarily controlled should be exempted from consolidation, similar to the current IPSAS 6 provisions, and that relevant information, consistent with user needs as discussed below, should be presented. Also, this member believes that sufficient criteria can be developed for identifying such entities. For example, the following characteristics could be used to identify such entities: (1) control results from exceptional interventions in the private sector, (2) control over the entity is not expected to be permanent, and (3) investment recoverability and identification of any further risks are the principal user information needs. Such characteristics are described more fully below. Consolidating such entities would result in misstatements of the public sector entity's financial position and financial performance, and misleading financial statement presentation that does not meet user needs.

Exceptional public sector intervention in the private sector

In response to exceptional circumstances, such as economic instability or security concerns, a public sector entity may exercise regulatory or other sovereign powers and intervene in private sector entities. Some of these interventions may result in control over a private sector entity, while others do not. Such interventions arise because of the public sector entity's broad responsibility for the well-being of its jurisdiction, rather than routine public sector activities. Such intervention actions may relate broadly to entire markets, to key industries, or specific entities. Control may be obtained for a variety of reasons, such as ensuring that the public sector entity will optimize the recovery of its investment, enhancing the likelihood that the entity will continue to operate, and preventing other investors from unfairly profiting from the intervention.

Control not expected to be permanent

For many interventions, it is clear at the time of acquisition that the public sector entity intends to dispose of its interests as soon as economically practicable and that control is not expected to be permanent, but rather is expected to be temporary. Such expectations may be made clear through legislation or other actions of the public sector entity. In some instances, the entities may be controlled through specific legal structures, such as conservatorships and receiverships, which may indicate the intent of the public sector entity's actions. For example, receiverships or conservatorships are established to liquidate failing institutions or to guide such institutions back to safe and sound conditions. Generally, such intervention entities are under some form of economic duress and the intervention provides temporary relief or liquidity to such entities. While the public sector entity plans to dispose of its investments in the intervention entities as soon as economically practicable, the timing of the public sector entity's actions to dispose of its investments may be affected by its efforts to maximize the recovery of the public sector entity's investments in the intervention entities, as well as by the financial health of the intervention entities and market conditions. Because of the unique and often severe conditions leading to these public sector interventions, the exact period of control may not be known or estimable and may exceed one year, even though the public sector clearly intends control to be temporary. Consequently, the temporary nature of the control would need to be reconfirmed at the end of each reporting period.

Investment recoverability and identification of any further risks are the principal user information needs

Consistent with the public sector entity's intention to dispose of its interests as soon as economically practicable, the public sector entity's focus, which may be clearly indicated through laws or its actions, is on investment recovery and any future risks. Consequently, the principal user information needs relate to the public sector entity's accountability to the public regarding (1) the public sector entity's recoverability of its investments and any potential further public sector entity investments in the entity, and (2) minimizing loss of taxpayer funds. Accordingly, users' needs are best met through information about amounts invested, the market value or fair value of the investment (consistent with IPSAS 29), any additional liabilities or contingencies for future investment in such entities (in accordance with existing reporting standards), and disclosure of any additional risks that could result in future losses through additional disclosure requirements. In addition, such reporting should be consistent with other interventions for which control was not obtained or which are no longer controlled by the public sector entity.

Contrary to meeting such user needs, consolidation of intervention entities meeting the above characteristics would:

1. fail to provide useful information on the recoverability of investments in such temporarily controlled entities,
2. obscure the public sector entity's liabilities or risks with respect to the temporarily-controlled entity (because balances between the entities would be eliminated), and
3. provide misleading information about the public sector entity's financial resources and obligations by including intervention entity:
 - (a) assets (such as inventory and production plant) that are not available for the ongoing operations of the public sector entity
 - (b) liabilities that are not the responsibility of the public sector entity, and
 - (c) revenues and expenses that do not reflect the public sector entity's operations.

Further, disclosure of recoverability information would not be an effective substitute for proper recognition. In addition, consolidation and deconsolidation within a relatively short period of time (e.g., 2-3 years) could lead to user confusion and significant costs.

Finally, if such intervention entities were consolidated, the overall cost to the public sector entity to prepare and audit the financial information of such intervention entities could be significant. These entities may be required to continue to file audited financial statements on a private sector GAAP basis with security regulators. The financial statements would need to be analyzed and converted, as necessary, to IPSAS standards and the public sector entity would likely directly bear the additional cost of the audit.

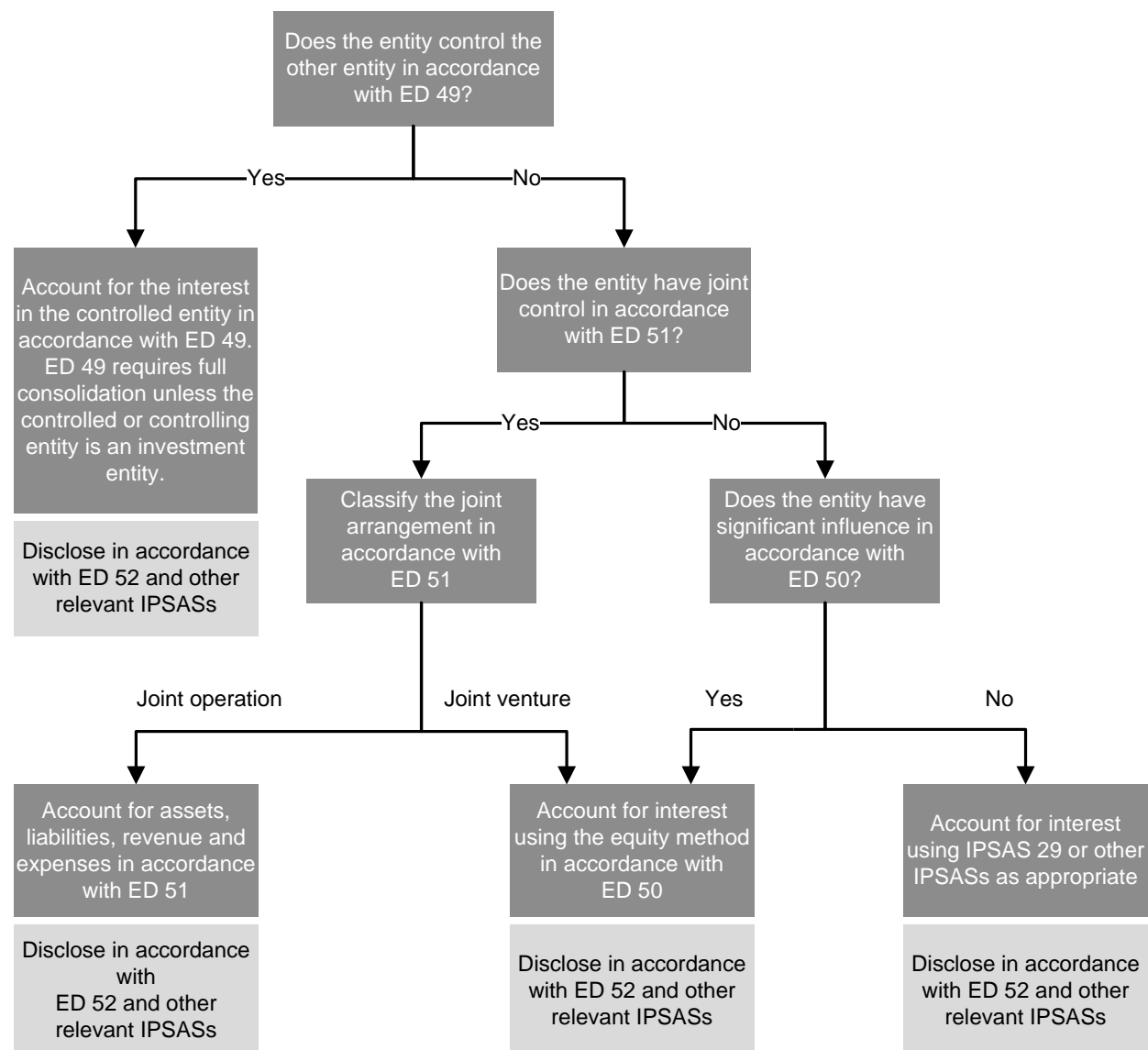
Implementation Guidance

This guidance accompanies, but is not part of, IPSAS X (ED 49), Consolidated Financial Statements.

Nature of Relationship with Another Entity

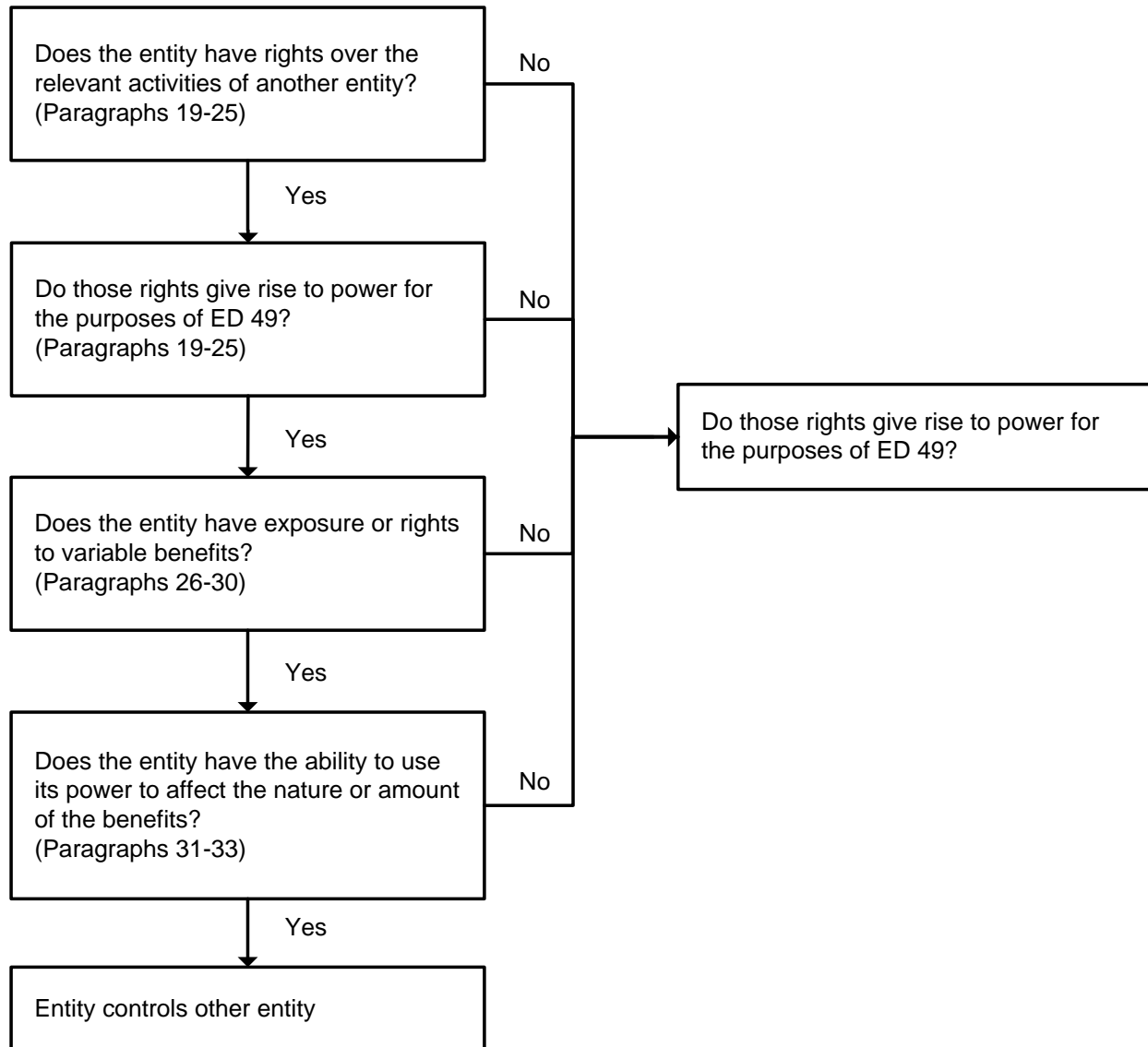
IG1. The diagram below summarizes the accounting for various types of involvement with another entity.

Flowchart 1: Forms of Involvement with Other Parties



Assessing Control of Another Entity for Financial Reporting Purposes

IG2. The diagram below summarizes the key issues an entity will need to consider in deciding whether it has control of another entity.

Flowchart 2: Assessing Control of Another Entity for Financial Reporting Purposes

Illustrative Examples

These examples accompany, but are not part of, IPSAS XX (ED 49), Consolidated Financial Statements.

- IE1. The examples in this appendix portray hypothetical situations. Although some aspects of the examples may be present in actual fact patterns, all facts and circumstances of a particular fact pattern would need to be evaluated when applying IPSAS XX (ED 49).

Power (paragraphs AG9–AG56)

- IE2. The following example illustrates an assessment of whether power exists.

Example 1

A state government partially funds the activities of a local government. Some of this funding is required to be spent on specified activities. The local government has a council that is elected every four years by the local community. The council decides how to use the local government's resources for the benefit of the local community. The activities of the local government are diverse and include library services, provision of leisure facilities, management of refuse and wastewater, and enforcement of building and health and safety regulations. These activities are the relevant activities of the local government. Many of these activities also coincide with the interests of the state government.

Despite its partial funding of the local government's activities, the state government does not have the power to direct the relevant activities of the local government. The rights of the local government over the relevant activities preclude the state government from having control.

Regulatory Control (paragraph AG12)

- IE3. The following examples illustrate various forms of regulatory control. None of these forms of regulatory control give rise to power over the relevant activities for the purposes of this Standard.

Example 2

A pollution control authority has the power to close down the operations of entities that are not complying with environmental regulations.

The existence of this power does not constitute power over the relevant activities.

Example 3

A city has the power to pass zoning laws to limit the location of fast food outlets or to ban them altogether.

The existence of this power does not constitute power over the relevant activities of the fast food outlets.

Example 4

A central government has the power to impose regulatory control on monopolies. A wholly owned government agency has the power to regulate monopolies that are subject to regulatory control and has established price ceilings for entities that distribute electricity. Neither the central government, nor the government agency, has power over the relevant activities of the electricity distributors.

Example 5

A gaming control board (GCB) is a government agency that regulates casinos and other types of gaming in a state, and enforces state gaming legislation. The GCB is responsible for promulgating rules and regulations that govern the conduct of gaming activities in the state. The rules and regulations stem from legislation. The legislation was passed by the legislature and sets forth the broad policy of the state with regard to gaming; while the rules and regulations provide detailed requirements that must be satisfied by a gaming establishment, its owners, employees, and vendors. The rules and regulations cover a broad range of activity, including licensing, accounting systems, rules of casino games, and auditing.

The GCB also has authority to grant or deny licenses to gaming establishments, their ownership, employees, and vendors. In order to obtain a license, an applicant must demonstrate that they possess good character, honesty and integrity. License application forms typically require detailed personal information. Based upon the type of license being sought, an applicant may also be required to disclose details regarding previous business relationships, employment history, criminal records, and financial stability.

Although the rules and regulations have an impact on how gaming establishments operate, the GCB does not have power over the relevant activities of the gaming establishments. The regulations apply to all gaming establishments and each establishment has a choice as to whether it wishes to engage in gaming or not. The purpose of the gaming legislation and regulations is to protect the public.

Relevant Activities and Direction of Relevant Activities (paragraphs AG13–AG15)

- IE4. The following examples illustrate assessments of whether an entity has the power to direct the relevant activities of another entity.

Example 6

Entities A and B, form another entity, entity C, to develop and market a medical product. Entity A is responsible for developing and obtaining regulatory approval of the medical product—that responsibility includes having the unilateral ability to make all decisions relating to the development of the product and to obtaining regulatory approval. Once the regulator has approved the product, entity B will manufacture and market it—entity B has the unilateral ability to make all decisions about the manufacture and marketing of the product. If all the activities—developing and obtaining regulatory approval as well as manufacturing and marketing of the medical product—are relevant activities, entity A and entity B each needs to determine whether

they are able to direct the activities that *most* significantly affect the benefits from entity C. Accordingly, entity A and B each need to consider whether developing and obtaining regulatory approval or the manufacturing and marketing of the medical product is the activity that most significantly affects the benefits from entity C and whether they are able to direct that activity. In determining which entity has power, entities A and B would consider:

- (a) The purpose and design of entity C;
- (b) The factors that determine the surplus, revenue and value of entity C as well as the value of the medical product;
- (c) The effect of their decision-making authority on entity C's performance with respect to the factors in (b); and
- (d) Their exposure to variability of benefits from entity C.

In this particular example, the entities would also consider:

- (e) The uncertainty of, and effort required in, obtaining regulatory approval (considering their record of successfully developing and obtaining regulatory approval of medical products); and
- (f) Which entity controls the medical product once the development phase is successful.

Example 7

An investment vehicle is created and financed with a debt instrument held by an entity (the debt investor) and equity instruments held by a number of other investors. The equity tranche is designed to absorb the first losses and to receive any residual benefit from the investment vehicle. One of the equity investors who holds 30 per cent of the equity instruments is also the asset manager. The investment vehicle uses its proceeds to purchase a portfolio of financial assets, exposing the investment vehicle to the credit risk associated with the possible default of principal and interest payments of the assets. The transaction is marketed to the debt investor as an investment with minimal exposure to the credit risk associated with the possible default of the assets in the portfolio because of the nature of these assets and because the equity tranche is designed to absorb the first losses of the investment vehicle. The benefits from the investment vehicle are significantly affected by the management of the investment vehicle's asset portfolio, which includes decisions about the selection, acquisition and disposal of the assets within portfolio guidelines and the management upon default of any portfolio assets. All those activities are managed by the asset manager until defaults reach a specified proportion of the portfolio value (i.e., when the value of the portfolio is such that the equity tranche of the investment vehicle has been consumed). From that time, a third-party trustee manages the assets according to the instructions of the debt investor. Managing the investment vehicle's asset portfolio is the relevant activity of the investment vehicle. The asset manager has the ability to direct the relevant activities until defaulted assets reach the specified proportion of the portfolio value; the debt investor has the ability to direct the relevant activities when the value of defaulted assets surpasses that specified proportion of the portfolio value. The asset manager and the debt investor each need to determine whether they are able to direct the activities that most significantly affect the benefits from the investment vehicle, including considering the purpose and design of the investment vehicle as well as each party's exposure to variability of benefits.

Rights that Give an Entity Power over another Entity (paragraphs AG16–AG28)

- IE5. The following examples illustrate assessments of whether an entity has the power to direct the relevant activities of another entity.

Example 8

A government housing agency establishes a community housing program that provides low-cost housing. The program is operated under an agreement with an incorporated association. The association's only activity is to manage the community housing facility. The association has no ownership instruments.

The board of governors of the association has 16 members, with eight appointed by (and subject to removal by) the government housing agency. By tradition, the chair of the association is appointed by the board from amongst the appointees of the government housing agency. The chair of the association has a casting vote that is rarely exercised.

The government housing agency owns the land on which the housing facilities stand and has contributed capital and operating funds to the association over the life of the facilities. The association owns the housing facilities.

The association retains any surplus resulting from the operation of the facilities and under its constitution is unable to provide a financial return to the government housing agency. The above fact pattern applies to examples 8A and 8B described below. Each example is considered in isolation.

Example 8A

The government housing agency has rights that give it the current ability to direct the relevant activities of the association, regardless of whether it chooses to exercise those rights.

The government housing agency also has rights to variable benefits from its involvement with the association. Even though the government housing agency has never received (and cannot receive) a financial return, the government housing agency is receiving benefits through the association furthering its social objective of providing low-cost community housing. In addition, the government housing agency has the ability to use its powers over the composition of the board of governors of the association to affect the amount of its benefits.

Based on the facts and circumstances outlined above, the government housing agency controls the association.

Example 8B

In this example, the facts of Example 8A apply, except that:

- (a) The association's board of governors is elected through a public nomination and voting process. The government housing agency does not have power to appoint board members; and
- (b) Decisions made by the association's board are reviewed by the government housing agency but it is unable to replace board members as a form of veto.

The government housing agency may still consider that it receives indirect, non-financial benefits from the association in that the agency's social objectives in relation to low-cost community housing are being furthered by the activities of the association. However, congruence of objectives alone is insufficient to conclude that one entity controls another entity (refer paragraph 30).

Based on the facts and circumstances outlined above, the government housing agency does not hold sufficient power over the association to direct its relevant activities and therefore does not control the association.

Example 9

A government has the right to appoint and remove the majority of members of a statutory body. This power has been used by previous governments. The current government has not done so because it does not wish, for political reasons, to be regarded as interfering in the activities of the statutory body. In this case the government still has substantive rights, even though it has chosen not to use them.

Example 10

A local government has a policy that, where it holds land that is surplus to its requirements, consideration should be given to making the land available for affordable housing. The local government establishes terms and conditions to ensure that the housing provided remains affordable and available to meet local housing needs.

In accordance with this policy, the local government sold part of a site to a housing association for CU1 to provide 20 affordable homes. The remainder of the site was sold at open market value to a private developer.

The contract between the local government and the housing association specifies what the land can be used for, the quality of housing developments, ongoing reporting and performance management requirements, the process for return of unused land and dispute resolution. The land must be used in a manner consistent with the local government's policy for affordable housing.

The agreement also has requirements regarding the housing association's quality assurance and financial management processes. The housing association must demonstrate that it has the capacity and authority to undertake the development. It must also demonstrate the added value that can be achieved by joining the local government's resources with that of the housing association to address a need within a particular client group in a sustainable way.

The Board of the housing association is appointed by the members of the housing association. The local government does not have a representative on the Board.

Based on the facts and circumstances outlined above, the government housing agency does not hold sufficient power over the association to direct its relevant activities and therefore does not control the association. The local government may receive indirect, non-financial benefits from the association in that the local government's social objectives in relation to low-cost community housing are being furthered by the activities of the housing association. However, congruence of

objectives alone is insufficient to conclude that one entity controls another (see paragraph 30). In order to have power over the housing association the local government would need to have the ability to direct the housing association to work with the local government to further the local governments' objectives.

Example 11

An entity being assessed for control has annual shareholder meetings at which decisions to direct the relevant activities are made. The next scheduled shareholders' meeting is in eight months. However, shareholders that individually or collectively hold at least 5 per cent of the voting rights can call a special meeting to change the existing policies over the relevant activities, but a requirement to give notice to the other shareholders means that such a meeting cannot be held for at least 30 days. Policies over the relevant activities can be changed only at special or scheduled shareholders' meetings. This includes the approval of material sales of assets as well as the making or disposing of significant investments.

The above fact pattern applies to examples 11A–11D described below. Each example is considered in isolation.

Example 11A

An entity holds a majority of the voting rights in the other entity. The entity's voting rights are substantive because the entity is able to make decisions about the direction of the relevant activities when they need to be made. The fact that it takes 30 days before the entity can exercise its voting rights does not stop the entity from having the current ability to direct the relevant activities from the moment the entity acquires the shareholding.

Example 11B

An entity is party to a forward contract to acquire the majority of shares in the other entity. The forward contract's settlement date is in 25 days. The existing shareholders are unable to change the existing policies over the relevant activities because a special meeting cannot be held for at least 30 days, at which point the forward contract will have been settled. Thus, the entity has rights that are essentially equivalent to the majority shareholder in example 11A above (i.e., the entity holding the forward contract can make decisions about the direction of the relevant activities when they need to be made). The entity's forward contract is a substantive right that gives the entity the current ability to direct the relevant activities even before the forward contract is settled.

Example 11C

An entity holds a substantive option to acquire the majority of shares in the other entity that is exercisable in 25 days and is deeply in the money. The same conclusion would be reached as in example 11B.

Example 11D

An entity is party to a forward contract to acquire the majority of shares in the other entity, with no other related rights over the other entity. The forward contract's settlement date is in six months. In contrast to the examples above, the entity does not have the current ability to direct the

relevant activities. The existing shareholders have the current ability to direct the relevant activities because they can change the existing policies over the relevant activities before the forward contract is settled.

Power without a Majority of the Voting Rights Special Voting Rights Attaching to Ownership Interests (paragraphs AG36–AG37)

- IE6. The following examples illustrate assessments of whether special voting rights attaching to ownership interests in another entity give rise to power.

Example 12

A central government has privatized a number of entities. In the case of certain strategic entities which it has wished to privatize without risking national interests it has used a “golden share” mechanism to give it veto power for certain of the most important decisions to be taken by the company. The “golden share” does not have any value or percentage in the charter capital of the company.

The central government has protective rights, not substantive rights, in respect of these companies.

Example 13

A central government sold all of its shares in a company, but kept a golden share (with a nominal value of one currency unit) which allows it to veto foreign control of the board or company.

The central government has protective rights, not substantive rights, in respect of these companies.

Example 14

A central government does not own any shares in defense companies. However it has passed legislation which specifies that, with respect to companies carrying out strategic activities for the defense and national security system, in the event that fundamental interests of national defense or security could be materially affected, the government may:

- (a) Impose specific conditions on the purchase of an interest in any such company – by any person – relating to the security of procurement and of information, the transfer of technologies and export controls;
- (b) Veto the purchase by any person – other than the state (whether directly or indirectly, individually or jointly) – of an interest in the voting share capital in any such company that, given its size, may jeopardize defense or national security; and
- (c) Veto the adoption of resolutions by the shareholders or the board of directors of any such company relating to certain extraordinary transactions (such as mergers, de-mergers, assets disposals, winding up, and bylaws amendments concerning the corporate purpose or equity ownership caps in certain state-controlled companies).

The central government has protective rights, not substantive rights, in respect of these companies.

Control of the Board or Other Governing Body (paragraph AG38)

- IE7. The following examples illustrate assessments of whether an entity has control of the board or governing body of another entity. The existence of such control may provide evidence that an entity has sufficient rights to have power over another entity.

Example 15

A national museum is governed by a board of trustees who are chosen by the government department responsible for funding the museum. The trustees have freedom to make decisions about the operation of the museum.

The department has the power to appoint the majority of the museum's trustees. The department has the potential to exercise power over the museum.

Economic Dependence (paragraphs AG41–AG42)

- IE8. The following examples illustrate assessments of whether dependence on funding from another entity gives rise to power in the context of this Standard.

Example 16

A research institution is one of many institutions that receive the majority of their funding from a central government. The institutions submit proposals and the funding is allocated through a tendering process. The research institution retains the right to accept or decline funding.

The central government does not control the research institution because the research institution can choose to decline funding from the government, seek alternative sources of funding or cease to operate.

Example 17

A catering entity has a binding arrangement to supply food to a government-owned school. The arrangement is between the company and the school. The school contracts generate the majority of the revenue of the catering entity. There are general requirements, set out in regulations, which are applicable to all such arrangements including nutritional standards and policies on procurement. For example, the arrangements specify how much produce must be purchased locally.

Current arrangements are for a period of five years. At the end of this period, if the catering entity wishes to continue supplying school meals it is required to go through a tendering process and compete with other entities for the business.

The school does not control the catering entity because the catering entity can choose to stop supplying school meals, seek other work, or cease to operate.

Example 18

An international donor funds a project in a developing country. The donor uses a small, local agency in the country to run the project. The local agency has its own management board but is

highly dependent on the donor for funding. The agency retains the power to turn down funding from the donor.

The international donor does not control the local agency because the agency can choose not to accept funding from the donor and seek alternative sources of funding, or cease to operate.

Voting Rights (paragraphs AG43–AG48)

- IE9. The following examples illustrate assessments of whether an entity with less than a majority of the voting rights in another entity has the practical ability to direct the relevant activities unilaterally, and whether its rights are sufficient to give it power over that other entity.

Example 19

An entity acquires 48 per cent of the voting rights of another entity. The remaining voting rights are held by thousands of shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders has any arrangements to consult any of the others or make collective decisions. When assessing the proportion of voting rights to acquire, on the basis of the relative size of the other shareholdings, the entity determined that a 48 per cent interest would be sufficient to give it control. In this case, on the basis of the absolute size of its holding and the relative size of the other shareholdings, the entity concludes that it has a sufficiently dominant voting interest to meet the power criterion without the need to consider any other evidence of power.

Example 20

Entity A holds 40 per cent of the voting rights of another entity and twelve other investors each hold 5 per cent of the voting rights of the other entity. A shareholder agreement grants Entity A the right to appoint, remove and set the remuneration of management responsible for directing the relevant activities. To change the agreement, a two-thirds majority vote of the shareholders is required. In this case, Entity A concludes that the absolute size of its holding and the relative size of the other shareholdings alone are not conclusive in determining whether it has rights sufficient to give it power. However, Entity A determines that its contractual right to appoint, remove and set the remuneration of management is sufficient to conclude that it has power over the other entity. The fact that Entity A might not have exercised this right or the likelihood of Entity A exercising its right to select, appoint or remove management shall not be considered when assessing whether Entity A has power.

Example 21

Entity A holds 45 per cent of the voting rights of another entity. Two other investors each hold 26 per cent of the voting rights of the other entity. The remaining voting rights are held by three other shareholders, each holding 1 per cent. There are no other arrangements that affect decision-making. In this case, the size of Entity A's voting interest and its size relative to the other shareholdings are sufficient to conclude that Entity A does not have power. Only two other investors would need to co-operate to be able to prevent Entity A from directing the relevant activities of the other entity.

Example 22

An entity holds 45 per cent of the voting rights of another entity. Eleven other shareholders each hold 5 per cent of the voting rights of the other entity. None of the shareholders has contractual arrangements to consult any of the others or make collective decisions. In this case, the absolute size of the entity's holding and the relative size of the other shareholdings alone are not conclusive in determining whether the entity has rights sufficient to give it power over the other entity. Additional facts and circumstances that may provide evidence that the entity has, or does not have, power shall be considered.

Example 23

An entity holds 35 per cent of the voting rights of another entity. Three other shareholders each hold 5 per cent of the voting rights of the other entity. The remaining voting rights are held by numerous other shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders has arrangements to consult any of the others or make collective decisions. Decisions about the relevant activities of the other entity require the approval of a majority of votes cast at relevant shareholders' meetings—75 per cent of the voting rights of the other entity have been cast at recent relevant shareholders' meetings. In this case, the active participation of the other shareholders at recent shareholders' meetings indicates that the entity would not have the practical ability to direct the relevant activities unilaterally, regardless of whether the entity has directed the relevant activities because a sufficient number of other shareholders voted in the same way as the entity.

Potential Voting Rights (paragraphs AG49–AG52)

IE10. The following examples illustrate assessments of whether potential voting rights are substantive.

Example 24

Entity A holds 70 per cent of the voting rights of another entity. Entity B has 30 per cent of the voting rights of the other entity as well as an option to acquire half of Entity A's voting rights. The option is exercisable for the next two years at a fixed price that is deeply out of the money (and is expected to remain so for that two-year period). Entity A has been exercising its votes and is actively directing the relevant activities of the other entity. In such a case, Entity A is likely to meet the power criterion because it appears to have the current ability to direct the relevant activities. Although Entity B has currently exercisable options to purchase additional voting rights (that, if exercised, would give it a majority of the voting rights in the other entity), the terms and conditions associated with those options are such that the options are not considered substantive.

Example 25

Entity A and two other investors each hold a third of the voting rights of another entity. The other entity's business activity is closely related to Entity A. In addition to its equity instruments, Entity A also holds debt instruments that are convertible into ordinary shares of the other entity at any time for a fixed price that is out of the money (but not deeply out of the money). If the debt were converted, Entity A would hold 60 per cent of the voting rights of the other entity. Entity A would

benefit from realizing synergies if the debt instruments were converted into ordinary shares. Entity A has power over the other entity because it holds voting rights of the other entity together with substantive potential voting rights that give it the current ability to direct the relevant activities.

Power when Voting or Similar Rights do not have a Significant Effect on Benefits
(paragraphs AG53–AG56)

- IE11. The following examples illustrate assessments of whether an entity has power in the absence of voting rights or similar rights.

Example 26

A central government has legislation that governs the establishment of cultural and heritage boards. These boards have a separate legal status and have limited liability. The powers and objectives of the boards, along with their reporting requirements are specified by legislation. The main function of each board is to administer the board's assets, mainly property, for the general benefit of beneficiaries. Boards are permitted to spend money on the promotion of health, education, vocational training, and the social and economic welfare of the beneficiaries. They have limited authority to spend money unless it is for a purpose specifically mentioned in the legislation. Each board must deliver an annual financial report to the government. The beneficiaries (as defined by each board and comprising people from a specified area) elect the members of the board. Trustees are appointed for a three-year term by way of voting by beneficiaries at the annual general meeting. Strategy is determined by the board.

The central government does not control the boards. The government was involved in establishing the legislation that governs the activities of the boards, but it has not obtained rights that give it power over the boards. Despite the fact that their powers are limited by legislation, each board is responsible for determining its own operating and financial policies.

Example 27

Five local authorities create a separate company to deliver shared services to participating authorities. The company operates under contract to these local authorities. The company's major objective is the provision of services to these local authorities.

The company is owned by all of the participating local authorities with each owning one share and allowed one vote. The chief executive of each local government is permitted to be a board member of the company. The board of the company is responsible for strategic direction, approval of business cases and monitoring of performance.

For each shared activity there is an advisory group that is responsible for operational management and decision-making in relation to that activity. Each advisory group consists of one representative from each local government.

The benefits of the shared services arrangement are:

- Improved levels and quality of service;
- A co-ordinated and consistent approach to the provision of services;
- Reductions in the cost of support and administrative services;

- Opportunities to develop new initiatives; and
- Economies of scale resulting from a single entity representing many councils in procurement.

If further shared service activities are established that lead to the need for further capital, the company will either issue a new class of equity instrument or will form a controlled entity to hold the interest in the new assets.

The company covers its costs in two ways. It retains a percentage of savings from its bulk purchasing activities and it charges an administrative transaction cost of services provided to the local authorities.

None of the local authorities individually controls the company. They have joint control over the company.

Example 28

A leisure trust was established as a charity, limited by guarantee, to operate and manage sport and leisure facilities on behalf of a local government. Under the terms of the agreement with the local government, the leisure trust is responsible for the operational management, delivery and development of the city's sports and leisure facilities. The trust is required to operate the existing leisure facilities of the local government. The level of service required, including hours of operation and staffing levels, are specified by the local government. The leisure trust's activities must be consistent with the long-term plan of the local government and a significant portion of the trusts activities are funded by the local government. The leisure trust may not create new facilities nor may it engage in any other activities without the approval of the local government.

The articles of association of the leisure trust specify that there shall be no more than 13 directors. Out of that number, up to 8 directors may be drawn from elected members, officers or employees of the local government. The other 5 directors must be independent. That is, they must not be elected representatives, officers or employees of the local government nor may they be employees of the leisure trust.

If the leisure trust ceases to operate the proceeds must be distributed to another charity with similar purposes. The local government is not responsible for the debts of the leisure trust (its liability is limited to one currency unit).

The local government controls the leisure trust. By specifying in detail the way in which the leisure trust must operate the local government has predetermined the leisure trust's activities and the nature of benefits to the local government.

Example 29

A local government transfers its leisure centers, libraries and theatres into a charitable trust.

In creating the trust the local government expects to benefit from cost savings, increased use of facilities by the public, a more favorable taxation treatment, and better access to funding restricted to charities. The trust can decide the nature and extent of facilities to be provided and can engage in any other charitable purpose. The board of the trust is elected by the community. The local government is entitled to have one representative on the board. The trust is required to retain any surplus and use it for the objectives of the trust.

The local government benefits from the trust's activities but it does not control the trust. The local government cannot direct how the trust uses its resources.

Example 30

A local government has transferred its sports and leisure facilities into a charitable trust. The local government has the right to appoint one of its councilors to the board of the trust. The board of the trust has nine members. The local government is entitled to ten percent of the trust's surplus for the year or, in the case of the deficit, may be required to contribute up to ten percent of the deficit for the year. The trust board determines the strategy of the trust and is ultimately responsible for the policies of the trust.

The local government does not control the trust.

Example 31

A funding agency was established by legislation. It is owned by ten local authorities and the central government. It operates on a for-profit basis. The funding agency will raise debt funding and provide that funding to the participating local authorities. Its primary purpose is to provide more efficient funding costs and diversified funding sources for the local authorities. It may undertake any other activities considered by the board to be reasonably related or incidental to, or in connection with, that business.

The main benefits to the participating local authorities are the reduced borrowing costs. The board of the funding agency may decide to pay dividends but dividend payments are expected to be low.

The board is responsible for the strategic direction and control of the funding agency's activities. The board will comprise between four and seven directors with a majority of independent directors.

There is also a shareholders' council which is made up of ten appointees of the shareholders (including an appointee from the central government). The role of the shareholders' council is to:

- Review the performance of the funding agency and the Board, and report to shareholders on that performance;
- Make recommendations to shareholders as to the appointment, removal, replacement and remuneration of directors; and
- Coordinate shareholders' governance decisions.

The funding agency purchases debt securities in accordance with its lending and/or investment policies, as approved by the board and/or shareholders.

To participate in the funding agency as a principal shareholding authority, each local government made an initial capital investment of CU100,000, provided security against future property taxes and agreed to borrow a set portion of its borrowing needs from the funding agency for a period of three years.

The funding agency is jointly controlled by the central government and the participating local authorities.

Example 32

Entity A's only business activity, as specified in its founding documents, is to purchase receivables and service them on a day-to-day basis for Entity B. The servicing on a day-to-day basis includes the collection and passing on of principal and interest payments as they fall due. Upon default of a receivable Entity A automatically puts the receivable to Entity B as agreed separately in a put agreement between Entity A and Entity B. The only relevant activity is managing the receivables upon default because it is the only activity that can significantly affect Entity A's financial performance. Managing the receivables before default is not a relevant activity because it does not require substantive decisions to be made that could significantly affect Entity A's financial performance—the activities before default are predetermined and amount only to collecting cash flows as they fall due and passing them on to Entity B. Therefore, only Entity B's right to manage the assets upon default should be considered when assessing the overall activities of Entity A that significantly affect Entity A's financial performance. In this example, the design of Entity A ensures that Entity B has decision-making authority over the activities that significantly affect the financial performance at the only time that such decision-making authority is required. The terms of the put agreement are integral to the overall transaction and the establishment of Entity A. Therefore, the terms of the put agreement together with the founding documents of Entity A lead to the conclusion that Entity B has power over Entity A even though Entity B takes ownership of the receivables only upon default and manages the defaulted receivables outside the legal boundaries of Entity A.

Example 33

The only assets of Entity A are receivables. When the purpose and design of Entity A are considered, it is determined that the only relevant activity is managing the receivables upon default. The party that has the ability to manage the defaulting receivables has power over the other entity, irrespective of whether any of the borrowers have defaulted.

Exposure, or Rights, to Variable Benefits from another Entity (paragraph AG57)

- IE12. The following examples illustrate assessments of whether an entity receives variable benefits from another entity.

Example 34

Research has shown that family friendly policies at universities, which include the provision of quality early childhood education services, are critical in attracting and retaining students and staff. This is particularly important for attracting high-level staff and post-graduate students, which in turn help uphold the reputation of the University and its ability to obtain research funding.

The above background information is relevant to examples 34A and 34B described below. Each example is considered in isolation.

Example 34A

University A has established seven childcare centers (although University A receives government funding for its educational programs, the childcare centers have been established by the university, not by the government). The centers operate in University owned buildings. Each center has its own manager, staff and budget. The centers are able to be used by university staff and students only. The University is the licensed provider of childcare services. The University has the right to close centers or relocate them to other properties. Because the childcare center is on university property the staff and parents are required to comply with University health and safety policies. The management team of the childcare center has the ability to determine all other operating policies.

University A receives non-financial benefits from having childcare services available on campus. Although University A is not involved in the day-to-day running of the centers, it has the ability to close the centers or change their hours of operation.

University A controls the childcare centers.

Example 34B

University B has made a building available free of charge for the provision of childcare services on the grounds of the University. The childcare services are provided by an incorporated society. All parents using the childcare center are members of the society. The members appoint the Board of the incorporated society and are in charge of the childcare center's operating and financial policies. The childcare center is able to be used by staff, students and the general public, with students having priority. Because the childcare center is on university property the staff and parents are required to comply with University health and safety policies. The incorporated society is the licensed provider of childcare services. If the incorporated society ceases to operate, its resources must be distributed to a similar non-profit organization. The incorporated society could choose not to use the University's buildings in providing its services.

Although the University receives non-financial benefits from having childcare services available on campus it does not control the incorporated society.

Link between Power and Benefits*Delegated Power (paragraphs AG58–AG62)*

- IE13. The following examples illustrate assessments of whether an entity is acting as a principal or an agent.

Example 35

A government department may be responsible for monitoring the performance of another public sector entity. The role of the monitoring department is to make sure the other entity's approach is consistent with the government's goals, provide Ministers with quality assurance about delivery and results and assess and notify the Minister of any risks. The department has an explicit agreement with the Minister which sets out its monitoring responsibilities. The department has the authority to request information from the other entity and provides advice to the Minister on any funding requests from that entity. The department also advises the Minister as to whether the

other entity should be permitted to undertake certain activities. The department is acting as an agent of the Minister.

Example 36

A provincial government establishes a trust to co-ordinate fundraising efforts for the benefit of health programs and other health initiatives in the region. The trust also invests and manages designated endowment funds. The funds raised are applied to the government-owned hospitals and aged care facilities in the region.

The provincial government appoints all the trustees on the board of the trust and funds the trust's operating costs. The trust is a registered charity and is exempt from income tax.

Based on the following analysis, the provincial government controls the trust:

- (a) The provincial government can give directions to the trustees, and the trustees have the current ability to direct the relevant activities of the trust. The trustees control the trust and the provincial government can replace the trustees at its discretion. The trustees' fiduciary obligation to act in the best interest of the beneficiaries does not prevent the provincial government from having power over the trust;
- (b) The provincial government has exposure and rights to variable benefits from involvement with the trust;
- (c) The provincial government can use its power over the trust to affect the nature and amount of the trust's benefits; and
- (d) The activities of the trust are complementary to the activities of the provincial government.

Example 37

A statutory body is established under legislation to deliver services to the community. The statutory body is responsible for its day-to-day operations and has a governing council that oversees its operations.

The Minister of Health for the provincial government appoints the statutory body's governing council and, subject to the Minister's approval, the statutory body's governing council appoints the chief executive of the body.

The provincial government Health Department acts as the "system manager" for the provincial health system on behalf of the Minister. This role includes:

- (a) Strategic leadership, such as the development of health service plans;
- (b) Giving directions for the delivery of health services. The Health Department can give directions on matters such as entering into service agreements, capital works approval and management of industrial relations, including employment terms and conditions for the statutory body's employees; and
- (c) Monitoring of performance (e.g., quality of health services and financial data) of the authority and taking remedial action when performance does not meet specified performance measures.

Although the Health Department holds decision-making authority in regard to the statutory body, it

requires the Minister's approval for the following decisions:

- (a) Entering into service agreements with the body;
- (b) Issuing binding health service directives;
- (c) Development of health service plans and capital works management and planning; and
- (d) Employment and remuneration of senior staff.

The Health Department receives all its operating and capital funding from the provincial government.

Based on the facts and circumstances outlined above, the Health Department has delegated power to act as an agent of the Minister in relation to the statutory body. The Health Department's agency status is evident through the restricted decision-making authority held by the Department, the rights held by the Minister and the fact that the costs of the Department's activities in relation to the statutory body are paid for by the provincial government. The Health Department does not control the statutory body. However, the provincial government does control the statutory body.

Example 38

The facts are the same as in Example 37 except that:

- (a) The Health Department appoints the body's governing council, and the body's governing council appoints the chief executive of the statutory body;
- (b) The Health Department does not require the Minister's approval for its decisions as manager of provincial health services; and
- (c) The chief executive of the Health Department is held accountable for the performance of the statutory body.

In this example, the scope of the decision-making authority held by the Health Department has increased significantly to the extent that the Health Department has the current ability to direct the relevant activities of the statutory body so as to achieve the health service objectives of the Health Department. Therefore, based on the new facts and circumstances, the Department controls the statutory body. The control held is considered delegated control from the Minister.

Example 39

The head of the government department related to finance and taxation (the Treasury) is designated by law as the managing trustee for a number of investment funds. The investment funds are funded by designated taxes and are used to deliver federal welfare programs. The Treasury collects most of the designated tax revenue that relates to these funds. Other agencies also collect some of the revenues and forward these to the Treasury.

The Treasury is delegated the responsibility for administering the funds. For each of the funds, the Treasury immediately invests all receipts credited to the fund, and maintains the invested assets in a designated trust fund until money is needed by the relevant agency.

When the relevant agencies determine that monies are needed, the Treasury redeems securities from the funds' investment balances, and transfers the cash proceeds, including interest earned on the investments, to the program accounts for disbursement by the agency. The Treasury provides monthly and other periodic reporting to each agency. The Treasury charges a

management fee for its services.

The Treasury does not control the funds.

Example 40

A local government administers ten funds, each relating to a specific district. The funds hold specified assets (such as land, property and investments) that belonged to districts that previously had their own local government but which have since been amalgamated with other districts. The funds receive the revenue associated with the assets and certain taxes such as the property taxes for that district. The rights of the funds to hold these specified assets and receive the specified revenue are set out in legislation. The assets and revenue of the fund may be applied solely for the benefit of the inhabitants of the former districts.

The local government has wide discretion over spending by the funds. Funds must be applied for the benefit of the community in such a manner as using reasonable judgment the local government thinks proper and having regard to the interests of the inhabitants of the former district. The local government may apply the fund to spending which is not covered by council taxation. Expenditure charged to the fund must be for purposes permitted by law.

The funds are controlled by the local government.

Example 41

A sovereign wealth fund (the fund) is a constitutionally established permanent fund, managed by a government corporation. Legislation specifies that the fund is entitled to receive at least 25% of proceeds from oil sales. The fund sets aside a certain share of these revenues to benefit current and future generations of citizens.

The corporation manages the assets of both the fund and certain other state investments and is remunerated for doing so. The corporation may not spend the fund revenue. Decisions on spending fund revenue are made by the Parliament. Each year, the fund's revenue is split between operating expenses and an annual payment to residents that meet certain criteria specified in legislation.

The corporation does not control the sovereign wealth fund. It acts solely as an agent.

Example 42

A decision maker (fund manager) establishes, markets and manages a publicly traded, regulated fund according to narrowly defined parameters set out in the investment mandate as required by its local laws and regulations. The fund was marketed to investors as an investment in a diversified portfolio of equity securities of publicly traded entities. Within the defined parameters, the fund manager has discretion about the assets in which to invest. The fund manager has made a 10 per cent pro rata investment in the fund and receives a market-based fee for its services equal to 1 per cent of the net asset value of the fund. The fees are commensurate with the services provided. The fund manager does not have any obligation to fund losses beyond its 10 per cent investment. The fund is not required to establish, and has not established, an independent board of directors. The investors do not hold any substantive rights that would affect

the decision-making authority of the fund manager, but can redeem their interests within particular limits set by the fund.

Although operating within the parameters set out in the investment mandate and in accordance with the regulatory requirements, the fund manager has decision-making rights that give it the current ability to direct the relevant activities of the fund—the investors do not hold substantive rights that could affect the fund manager's decision-making authority. The fund manager receives a market-based fee for its services that is commensurate with the services provided and has also made a pro rata investment in the fund. The remuneration and its investment expose the fund manager to variability of benefits from the activities of the fund without creating exposure that is of such significance that it indicates that the fund manager is a principal.

In this example, consideration of the fund manager's exposure to variability of benefits from the fund together with its decision-making authority within restricted parameters indicates that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

Example 43

A decision maker establishes, markets and manages a fund that provides investment opportunities to a number of investors. The decision maker (fund manager) must make decisions in the best interests of all investors and in accordance with the fund's governing agreements. Nonetheless, the fund manager has wide decision-making discretion. The fund manager receives a market-based fee for its services equal to 1 per cent of assets under management and 20 per cent of all the fund's surplus if a specified level of surplus is achieved. The fees are commensurate with the services provided.

Although it must make decisions in the best interests of all investors, the fund manager has extensive decision-making authority to direct the relevant activities of the fund. The fund manager is paid fixed and performance-related fees that are commensurate with the services provided. In addition, the remuneration aligns the interests of the fund manager with those of the other investors to increase the value of the fund, without creating exposure to variability of benefits from the activities of the fund that is of such significance that the remuneration, when considered in isolation, indicates that the fund manager is a principal.

The above fact pattern and analysis applies to examples 44–46 described below. Each example is considered in isolation.

Example 44

The fund manager also has a 2 per cent investment in the fund that aligns its interests with those of the other investors. The fund manager does not have any obligation to fund losses beyond its 2 per cent investment. The investors can remove the fund manager by a simple majority vote, but only for breach of contract.

The fund manager's 2 per cent investment increases its exposure to variability of benefits from the activities of the fund without creating exposure that is of such significance that it indicates that the fund manager is a principal. The other investors' rights to remove the fund manager are considered to be protective rights because they are exercisable only for breach of contract. In this example, although the fund manager has extensive decision-making authority and is exposed to

variability of benefits from its interest and remuneration, the fund manager's exposure indicates that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

Example 45

The fund manager has a more substantial pro rata investment in the fund, but does not have any obligation to fund losses beyond that investment. The investors can remove the fund manager by a simple majority vote, but only for breach of contract.

In this example, the other investors' rights to remove the fund manager are considered to be protective rights because they are exercisable only for breach of contract. Although the fund manager is paid fixed and performance-related fees that are commensurate with the services provided, the combination of the fund manager's investment together with its remuneration could create exposure to variability of benefits from the activities of the fund that is of such significance that it indicates that the fund manager is a principal. The greater the magnitude of, and variability associated with, the fund manager's economic interests (considering its remuneration and other interests in aggregate), the more emphasis the fund manager would place on those economic interests in the analysis, and the more likely the fund manager is a principal.

For example, having considered its remuneration and the other factors, the fund manager might consider a 20 per cent investment to be sufficient to conclude that it controls the fund. However, in different circumstances (i.e., if the remuneration or other factors are different), control may arise when the level of investment is different.

Example 46

The fund manager has a 20 per cent pro rata investment in the fund, but does not have any obligation to fund losses beyond its 20 per cent investment. The fund has a board of directors, all of whose members are independent of the fund manager and are appointed by the other investors. The board appoints the fund manager annually. If the board decided not to renew the fund manager's contract, the services performed by the fund manager could be performed by other managers in the industry.

Although the fund manager is paid fixed and performance-related fees that are commensurate with the services provided, the combination of the fund manager's 20 per cent investment together with its remuneration creates exposure to variability of benefits from the activities of the fund that is of such significance that it indicates that the fund manager is a principal. However, the investors have substantive rights to remove the fund manager—the board of directors provides a mechanism to ensure that the investors can remove the fund manager if they decide to do so.

In this example, the fund manager places greater emphasis on the substantive removal rights in the analysis. Thus, although the fund manager has extensive decision-making authority and is exposed to variability of benefits of the fund from its remuneration and investment, the substantive rights held by the other investors indicate that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

Example 47

Entity A is created to purchase a portfolio of fixed rate asset-backed securities, funded by fixed rate debt instruments and equity instruments. The equity instruments are designed to provide first loss protection to the debt investors and receive any residual benefits from Entity A. The transaction was marketed to potential debt investors as an investment in a portfolio of asset-backed securities with exposure to the credit risk associated with the possible default of the issuers of the asset-backed securities in the portfolio and to the interest rate risk associated with the management of the portfolio. On formation, the equity instruments represent 10 per cent of the value of the assets purchased. A decision maker (the asset manager) manages the active asset portfolio by making investment decisions within the parameters set out in Entity A's prospectus. For those services, the asset manager receives a market-based fixed fee (i.e., 1 per cent of assets under management) and performance-related fees (i.e., 10 per cent of surplus) if Entity A's surpluses exceed a specified level. The fees are commensurate with the services provided. The asset manager holds 35 per cent of the equity instruments of Entity A. The remaining 65 per cent of the equity instruments, and all the debt instruments of Entity A, are held by a large number of widely dispersed unrelated third party investors. The asset manager can be removed, without cause, by a simple majority decision of the other investors.

The asset manager is paid fixed and performance-related fees that are commensurate with the services provided. The remuneration aligns the interests of the fund manager with those of the other investors to increase the value of the fund. The asset manager has exposure to variability of returns from the activities of the fund because it holds 35 per cent of the equity instruments and from its remuneration.

Although operating within the parameters set out in Entity A's prospectus, the asset manager has the current ability to make investment decisions that significantly affect Entity A's benefits in the form of returns—the removal rights held by the other investors receive little weighting in the analysis because those rights are held by a large number of widely dispersed investors. In this example, the asset manager places greater emphasis on its exposure to variability of returns of the fund from its net asset/equity interest, which is subordinate to the debt instruments. Holding 35 per cent of the equity instruments creates subordinated exposure to losses and rights to returns of Equity A, which are of such significance that it indicates that the asset manager is a principal. Thus, the asset manager concludes that it controls Entity A.

Example 48

A decision maker (the sponsor) sponsors a multi-seller conduit, which issues short-term debt instruments to unrelated third party investors. The transaction was marketed to potential investors as an investment in a portfolio of highly rated medium-term assets with minimal exposure to the credit risk associated with the possible default by the issuers of the assets in the portfolio. Various transferors sell high quality medium-term asset portfolios to the conduit. Each transferor services the portfolio of assets that it sells to the conduit and manages receivables on default for a market-based servicing fee. Each transferor also provides first loss protection against credit losses from its asset portfolio through over-collateralization of the assets transferred to the conduit. The sponsor establishes the terms of the conduit and manages the operations of the conduit for a market-based fee. The fee is commensurate with the services provided. The sponsor

approves the sellers permitted to sell to the conduit, approves the assets to be purchased by the conduit and makes decisions about the funding of the conduit. The sponsor must act in the best interests of all investors.

The sponsor is entitled to any residual benefit from the conduit and also provides credit enhancement and liquidity facilities to the conduit. The credit enhancement provided by the sponsor absorbs losses of up to 5 per cent of all of the conduit's assets, after losses are absorbed by the transferors. The liquidity facilities are not advanced against defaulted assets. The investors do not hold substantive rights that could affect the decision-making authority of the sponsor.

Even though the sponsor is paid a market-based fee for its services that is commensurate with the services provided, the sponsor has exposure to variability of benefits from the activities of the conduit because of its rights to any residual benefits from the conduit and the provision of credit enhancement and liquidity facilities (i.e., the conduit is exposed to liquidity risk by using short-term debt instruments to fund medium-term assets). Even though each of the transferors has decision-making rights that affect the value of the assets of the conduit, the sponsor has extensive decision-making authority that gives it the current ability to direct the activities that most significantly affect the benefits from the conduit (i.e., the sponsor established the terms of the conduit, has the right to make decisions about the assets (approving the assets purchased and the transferors of those assets) and the funding of the conduit (for which new investment must be found on a regular basis)). The right to residual benefits from the conduit and the provision of credit enhancement and liquidity facilities expose the sponsor to variability of benefits from the activities of the conduit that is different from that of the other investors. Accordingly, that exposure indicates that the sponsor is a principal and thus the sponsor concludes that it controls the conduit. The sponsor's obligation to act in the best interest of all investors does not prevent the sponsor from being a principal.

Investment Entities (paragraphs AG87–AG105)

IE14. The following examples illustrate assessments of whether an entity is an investment entity.

Example 49

An entity, Limited Partnership, is formed in 20X1 as a limited partnership with a 10-year life. The offering memorandum states that Limited Partnership's purpose is to invest in entities with rapid growth potential, with the objective of realizing capital appreciation over their life. Entity GP (the general partner of Limited Partnership) provides 1 per cent of the capital to Limited Partnership and has the responsibility of identifying suitable investments for the partnership. Approximately 75 limited partners, who are unrelated to Entity GP, provide 99 per cent of the capital to the partnership.

Limited Partnership begins its investment activities in 20X1. However, no suitable investments are identified by the end of 20X1. In 20X2 Limited Partnership acquires a controlling interest in one entity, ABC Corporation. Limited Partnership is unable to close another investment transaction until 20X3, at which time it acquires equity interests in five additional operating companies. Other than acquiring these equity interests, Limited Partnership conducts no other activities. Limited Partnership measures and evaluates its investments on a fair value basis and this information is

provided to Entity GP and the external investors.

Limited Partnership has plans to dispose of its interests in each of its investees during the 10-year stated life of the partnership. Such disposals include the outright sale for cash, the distribution of marketable equity securities to investors following the successful public offering of the investees' securities and the disposal of investments to the public or other unrelated entities.

Conclusion

From the information provided, Limited Partnership meets the definition of an investment entity from formation in 20X1 to 31 December 20X3 because the following conditions exist:

- (a) Limited Partnership has obtained funds from the limited partners and is providing those limited partners with investment management services;
- (b) Limited Partnership's only activity is acquiring equity interests in operating companies with the purpose of realizing capital appreciation over the life of the investments. Limited Partnership has identified and documented exit strategies for its investments, all of which are equity investments; and
- (c) Limited Partnership measures and evaluates its investments on a fair value basis and reports this financial information to its investors.

In addition, Limited Partnership displays the following characteristics that are relevant in assessing whether it meets the definition of an investment entity:

- (a) Limited Partnership is funded by many investors; and
- (b) Ownership in Limited Partnership is represented by units of partnership interests acquired through a capital contribution.

Limited Partnership does not hold more than one investment throughout the period. However, this is because it was still in its start-up period and had not identified suitable investment opportunities.

Example 50

High Technology Fund was formed by Technology Corporation to invest in technology start-up companies for capital appreciation. Technology Corporation holds a 70 per cent interest in High Technology Fund and controls High Technology Fund; the other 30 per cent ownership interest in High Technology Fund is owned by 10 investors. Technology Corporation holds options to acquire investments held by High Technology Fund, at their fair value, which would be exercised if the technology developed by the investees would benefit the operations of Technology Corporation. No plans for exiting the investments have been identified by High Technology Fund. High Technology Fund is managed by an investment adviser that acts as agent for the investors in High Technology Fund.

Conclusion

Even though High Technology Fund's business purpose is investing for capital appreciation and it provides investment management services to its investors, High Technology Fund is not an investment entity because of the following arrangements and circumstances:

- (a) Technology Corporation, the controlling entity of High Technology Fund, holds options to

acquire investments in investments held by High Technology Fund if the assets developed by those entities would benefit the operations of Technology Corporation. This provides a benefit in addition to capital appreciation or investment revenue; and

- (b) The investment plans of High Technology Fund do not include exit strategies for its investments, which are equity investments. The options held by Technology Corporation are not controlled by High Technology Fund and do not constitute an exit strategy.

Example 51

Real Estate Entity was formed to develop, own and operate retail, office and other commercial properties. Real Estate Entity typically holds its property in separate wholly-owned controlled entities, which have no other substantial assets or liabilities other than borrowings used to finance the related investment property. Real Estate Entity and each of its controlled entities report their investment properties at fair value in accordance with IPSAS 16, *Investment Property*. Real Estate Entity does not have a set time frame for disposing of its property investments, but uses fair value to help identify the optimal time for disposal. Although fair value is one performance indicator, Real Estate Entity and its investors use other measures, including information about expected cash flows, rental revenues and expenses, to assess performance and to make investment decisions. The key management personnel of Real Estate Entity do not consider fair value information to be the primary measurement attribute to evaluate the performance of its investments but rather a part of a group of equally relevant key performance indicators.

Real Estate Entity undertakes extensive property and asset management activities, including property maintenance, capital expenditure, redevelopment, marketing and tenant selection, some of which it outsources to third parties. This includes the selection of properties for refurbishment, development and the negotiation with suppliers for the design and construction work to be done to develop such properties. This development activity forms a separate substantial part of Real Estate Entity's business activities.

Conclusion

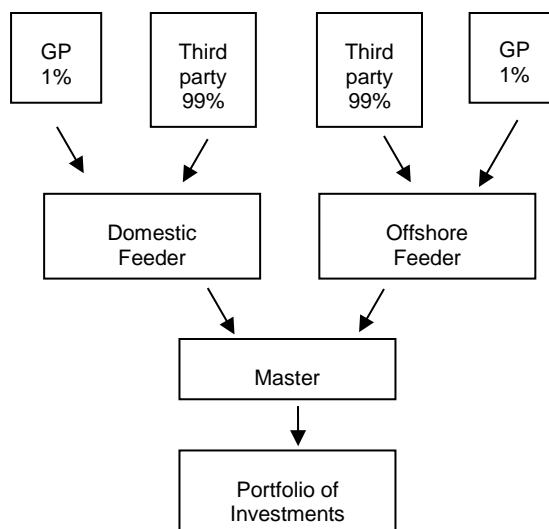
Real Estate Entity does not meet the definition of an investment entity because:

- (a) Real Estate Entity has a separate substantial business activity that involves the active management of its property portfolio, including lease negotiations, refurbishments and development activities, and marketing of properties to provide benefits other than capital appreciation, investment revenue, or both;
- (b) The investment plans of Real Estate Entity do not include specified exit strategies for its investments. As a result, Real Estate Entity plans to hold those property investments indefinitely; and
- (c) Although Real Estate Entity reports its investment properties at fair value in accordance with IPSAS 16, fair value is not the primary measurement attribute used by management to evaluate the performance of its investments. Other performance indicators are used to evaluate performance and make investment decisions.

Example 52

An entity, Master Fund, is formed in 20X1 with a 10-year life. The equity of Master Fund is held by two related feeder funds. The feeder funds are established in connection with each other to meet

legal, regulatory, tax or similar requirements. The feeder funds are capitalized with a 1 per cent investment from the general partner and 99 per cent from equity investors that are unrelated to the general partner (with no party holding a controlling financial interest).



The purpose of Master Fund is to hold a portfolio of investments in order to generate capital appreciation and investment revenue (such as dividends, interest or rental revenue). The investment objective communicated to investors is that the sole purpose of the Master-Feeder structure is to provide investment opportunities for investors in separate market niches to invest in a large pool of assets. Master Fund has identified and documented exit strategies for the equity and non-financial investments that it holds. Master Fund holds a portfolio of short- and medium-term debt investments, some of which will be held until maturity and some of which will be traded but Master Fund has not specifically identified which investments will be held and which will be traded. Master Fund measures and evaluates substantially all of its investments, including its debt investments, on a fair value basis. In addition, investors receive periodic financial information, on a fair value basis, from the feeder funds. Ownership in both Master Fund and the feeder funds is represented through units of equity.

Conclusion

Master Fund and the feeder funds each meet the definition of an investment entity. The following conditions exist:

- (a) Both Master Fund and the feeder funds have obtained funds for the purpose of providing investors with investment management services;
- (b) The Master-Feeder structure's business purpose, which was communicated directly to investors of the feeder funds, is investing solely for capital appreciation and investment revenue and Master Fund has identified and documented potential exit strategies for its equity and non-financial investments;
- (c) Although the feeder funds do not have an exit strategy for their interests in Master Fund,

the feeder funds can nevertheless be considered to have an exit strategy for their investments because Master Fund was formed in connection with the feeder funds and holds investments on behalf of the feeder funds; and

- (d) The investments held by Master Fund are measured and evaluated on a fair value basis and information about the investments made by Master Fund is provided to investors on a fair value basis through the feeder funds.

Master Fund and the feeder funds were formed in connection with each other for legal, regulatory, tax or similar requirements. When considered together, they display the following characteristics:

- (a) The feeder funds indirectly hold more than one investment because Master Fund holds a portfolio of investments;
- (b) Although Master Fund is wholly capitalized by the feeder funds, the feeder funds are funded by many investors who are unrelated to the feeder funds (and to the general partner); and
- (c) Ownership in the feeder funds is represented by units of equity interests acquired through a capital contribution.

Comparison with IFRS 10

IPSAS XX (ED 49), *Consolidated Financial Statements* is drawn primarily from IFRS 10, *Consolidated Financial Statements* (originally issued in 2011, including amendments published in July and October 2012). At the time of issuing this Standard, the IPSASB has not considered the applicability to public sector entities of certain IFRSs referred to in IFRS 10. These standards include:

- IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*; and
- IFRS 9, *Financial Instruments*.

The main differences between IPSAS XX (ED 49) and IFRS 10 are as follows:

- Commentary additional to that in IFRS 10 has been included in IPSAS XX (ED 49) to clarify the applicability of the Standard to accounting by public sector entities.
- IPSAS XX (ED 49) uses different terminology, in certain instances, from IFRS 10. The most significant examples are the use of the terms “statement of financial performance,” “net assets/equity,” “economic entity,” “controlling entity,” and “controlled entity”. The equivalent terms in IFRS 10 are “income statement,” “equity,” “group,” “parent,” and “subsidiary.” In many cases the terms “investor” and “investee” used in IFRS 10 are replaced by references to “an entity”, “another entity” or “an entity being assessed for control”. The terms “investor” and “investee” have been retained in the application guidance on investment entities as they are appropriate in that context.
- IFRS 10 identifies typical characteristics of an investment entity separately from the definition of an investment entity. IPSAS XX (ED 49) does not identify such typical characteristics. However, it does discuss some of these characteristics in the context of the definition of an investment entity.
- IPSAS XX (ED 49) contains more guidance on non-financial benefits.
- IPSAS XX (ED 49) does not require that a controlling entity, that is not itself an investment entity, shall consolidate all 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 and (ii) consolidates the other assets and liabilities and revenue and expenses of the controlled investment entity in accordance with IPSAS XX (ED 49).
- IPSAS XX (ED 49) contains additional illustrative examples that reflect the public sector context.

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