ACAG AUSTRALASIAN COUNCIL OF AUDITORS-GENERAL

26 February 2014

Ms Stephenie Fox
Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West, 6th Floor
Toronto, Ontario M5V 3H2 CANADA

Dear Ms Fox

IPSASB Exposure Drafts 48 to 52

Please find attached the Australasian Council of Auditors-General (ACAG) response to the following International Public Sector Accounting Standards Board (IPSASB) Exposure Drafts:

- ED 48 Separate Financial Statements
- ED 49 Consolidated Financial Statements
- ED 50 Investments in Associates and Joint Ventures
- ED 51 Joint Arrangements
- ED 52 Disclosure of Interests in Other Entities.

The views expressed in this submission represent those of all Australian members of ACAG.

ED 48 *Separate Financial Statements* (ED48)

ACAG believes that, as far as possible, the requirements of International Public Sector Accounting Standards (IPSASs) should align with those of International Financial Reporting Standards (IFRSs). Therefore, ACAG generally support the IPSASB's proposals in ED 48 as they are consistent with the corresponding proposals by the International Accounting Standards Board (IASB) to amend IAS 27 *Separate Financial Statements*. ACAG recommends that the IPSASB monitor this IASB project and proceed accordingly.

Please refer to Attachment 1 for responses to the specific matters for comment.

ED 49 *Consolidated Financial Statements* (ED49)

ACAG agrees with most of the proposals raised by IPSASB in relation to ED 49.

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ACAG believes the proposals are consistent with meeting the overall objectives of financial reporting outlined in the Conceptual Framework. The definition of control and the consolidation requirements will promote consistent and comparable public sector financial information. ACAG has reservations about some of the proposals regarding investment entities as they are not consistent with the IASB's equivalent standard IFRS 10 *Consolidated Financial Statements*.

Please refer to Attachment 2 for responses to the specific matters for comment.

ED 50 *Investments in Associates and Joint Ventures* and ED 51 *Joint Arrangements*.

ACAG has no comment to make on these exposure drafts.

ED 52 *Disclosure of Interests in Other Entities*.

ACAG has reservations about some of the proposals raised by the IPSASB in relation to ED 52.

Consistent with our comments on ED 49, ACAG does not support the divergence from IFRS in relation to investment entities. Further, ACAG believes an investment entity should be required to disclose information about significant judgements and assumptions it has made in determining its investment entity status regardless of whether it meets the investment entity criteria outlined in ED 49.

Please refer to Attachment 3 for responses to the specific matters for comment.

The opportunity to comment is appreciated and I trust you will find the attached comments useful.

Yours sincerely

Simon O'Neill
Chairman
ACAG Financial Reporting and Auditing Committee

IPSASB Exposure Draft 48: *Separate Financial Statements*

Specific Matter for Comment 1 - ***Do you agree generally with the proposals for separate financial statements? In particular, do you agree with the proposal to permit the use of the equity method, in addition to cost or fair value, for investments in other entities?***

ACAG generally agrees with the proposals for separate financial statements and in particular with the proposal to permit the use of the equity method, in addition to cost or fair value, for investments in the prescribed entities, in order to align with IFRSs.

ACAG believes that, as far as possible, the requirements of IPSASs should align with those of IFRSs. ACAG acknowledges that, as stated in paragraph BC4, the IASB has signalled its intention to amend IAS 27 *Separate Financial Statements* to restore the option to use the equity method in separate financial statements due to its use being required by corporate law in some countries (The IASB Exposure Draft ED/2013/10 *Equity Method in Separate Financial Statements* (Proposed amendments to IAS 27) has recently been issued). Therefore, ACAG recommends that the IPSASB monitor this IASB project and proceed accordingly.

In addition, ACAG agrees with the reasons stated in paragraph BC5 for the IPSASB to continue to permit the use of the equity method in separate financial statements. The equity method is a well-established method that can provide information that is reliable and useful in a cost-effective and easily understood manner.

ACAG supports the use in ED 48 of substantially the same structure and wording (subject to some specific IPSAS terminology changes) as in IAS 27. However, we have the following comments:

- ACAG notes that paragraph 14 includes a second sentence reproduced below that results from IPSASB's proposal in ED 49 *Consolidated Financial Statements* to extend the fair value treatment for investments of controlled investment entities by a controlling entity that is not itself an investment entity. Consistent with our comments on ED 49 not supporting this divergence from IFRSs, ACAG recommends this second sentence be omitted. However, should the IPSASB decide to proceed with the proposal, ACAG suggests the marked-up amendments:

  > *If a controlling entity that is not itself an investment entity is required, in accordance with paragraph 54 of IPSAS XX (ED 49), to measure ~~its investment in~~ the investments of a controlled investment entity at fair value through surplus or deficit in accordance with IPSAS 29, it shall also account for ~~those investments~~ <u>its investment in the controlled investment entity</u> in the same way in its separate financial statements.*

  This is because:

  - In respect of the deletion of 'its investment in', this phrase is redundant (Refer to the wording in paragraph 54 of ED 49).
  - In respect of the second amendment – In its separate financial statements, the controlling entity only has a direct investment in the investment entity (and not in the investments held by the investment entity).

- ACAG suggests that the phrase '(and its proportion of the voting rights, if different)' be added just after "proportion of the ownership interest" in both paragraphs 20(b)(iii) and 22(b)(iii), to reflect the corresponding IAS 27 requirements.

IPSASB Exposure Draft 49: *Consolidated Financial Statements*

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

ACAG agrees with the proposed definition that control occurs “when an entity has exposure to, or rights to, variable benefits from its involvement with another entity and through its power over that entity has the ability to affect the nature and amount of those benefits”.

This definition is largely consistent with the interpretation of the IASB’s corresponding standard, IFRS 10 *Consolidated Financial Statements*.

The new definition will require significantly more judgement in determining whether control exists, as it is based on the power to direct the relevant activities that significantly affect benefits rather than only the ‘power to govern the financial and operating policies’ currently under IPSAS 6. ACAG supports the IPSASB’s decision to expand the definition of power to include the right to direct the financial and operating policies of an entity. ACAG agrees that in the public sector, this ability can demonstrate power over relevant activities. The proposed standard provides detailed application guidance and provides a number of illustrative examples relevant to the public sector to assist entities in applying the new definition of control.

ACAG supports the use of the term ‘benefits’ as opposed to ‘returns’ currently used by the IASB when defining the concept of control. One of the IASB’s concerns was that the term ‘benefits’ could be misconstrued as relating only to financial benefits. ACAG believes the term ‘benefits’ implies benefits from both a financial and non-financial perspective whereas the term ‘returns’ implies a financial measurement. Regardless, the proposed standard clarifies that benefits ‘may be financial or non-financial’ and can include both ‘positive and negative aspects’.

The proposed standard defines power as the existence of rights and goes on to add that voting rights are not necessarily the only way to obtain power. This is particularly applicable to the public sector where rights are often created from statutory arrangements and enabling legislation. The proposed standard appropriately acknowledges this. In addition, the proposed standard provides that rights must be substantive (practical ability to exercise), not be protective, and relate to relevant activities. The proposed standard provides detailed application guidance and a number of illustrative examples which will help entities exercise the judgement required to determine whether rights are substantive or protective and whether they relate to relevant activities.

ACAG agrees with the IPSASBs position that:

- an entity does not have power over another entity solely from regulatory control or economic dependence, and

- the existence of statutory powers to operate independently does not preclude an entity from being controlled.

The illustrative examples are relevant to public sector entities and in most cases provide appropriate guidance to illustrate the concept of control. However, ACAG notes that for some of them, there is scope to expand on the discussion of the relevant principles in reaching the conclusions made. For instance, to help illustrate the concept articulated in paragraph 21 of the proposed standard, Example 35 should be expanded to include a clear conclusion (with reasoning) that the public sector entity and government department are controlled by the provincial government. Example 28 should also include a clear conclusion (with reasoning) that the local government can appoint the majority of the directors and therefore can direct the relevant activities of the leisure trust. Similarly in Example 34B, in reaching the 'no control' conclusion, the final paragraph should explain that the University does not have power over the incorporated society and outline the reasons why this is the case. ACAG recommends the IPSASB revisit the illustrative examples in light of these comments.

ACAG also notes that some of the illustrative examples are based on draft guidance developed by the Australian Accounting Standards Board (AASB) and may have to be updated following their finalisation by the AASB (e.g. Examples 8, 8A, 8B, 37, 38).

The proposed standard also provides that, where decision making authority has been delegated by a principal to an agent, an agent in such a relationship does not control the entity. The principal that has delegated the decision-making authority would consolidate the entity. This is relevant to the public sector and will continue to address reasons why some entities are excluded from consolidation.

ACAG supports the IPSASB's decision to align this standard with that of the IASB and believes the definition of control, the criteria and the additional application guidance will help to ensure there is consistent application and comparability between entities.

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 response to Specific Matter for Comment 3.***

ACAG agrees that a controlling entity should consolidate all controlled entities, except in the circumstances proposed.

The proposed definition of control ignores the structure of the entity and focuses on the concept of 'control'. ACAG believes this will reduce the likelihood of entities purposely manipulating structures to prevent certain outcomes being reported. ACAG does not believe any additional exemptions should be provided as this would not support the objective of the standard to introduce a single control model and would not support the overall objectives of financial reporting outlined in the Conceptual Framework. ACAG supports the proposed principles-based model.

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).***

ACAG agrees with the proposal to withdraw the exemption for temporarily controlled entities. ACAG believes the withdrawal will:

- remove the difficulties associated with identifying temporarily controlled entities
- remove the opportunities for entities to 'stretch' the temporarily controlled definition to manipulate desired reporting outcomes
- ensure all risks to which entities are exposed are reported.

Withdrawal of the exemption supports the main focus of the overall objectives of financial reporting outlined in the Conceptual Framework and aligns with the corresponding IFRS standard which requires the consolidation of temporarily controlled entities.

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?***

While ACAG believes departures from conceptual framework principles (such as the IFRS accounting treatment of investments by investment entities) should be avoided wherever possible, it agrees with the IPSASB proposals because the:

- proposals are consistent with IFRS 10. ACAG supports convergence with IFRS wherever possible, as it promotes comparability between the private and public sectors
- application of the departure from consolidation principles is limited to those entities meeting the definition of 'investment entities' outlined in the proposed standard
- definition of an 'investment entity' is consistent with that within IFRS 10. The restrictiveness of the definition means departure from consolidation principles will be limited – particularly in the public sector.

Specific Matter for Comment 5 - ***Do you agree that a controlling entity, that is not 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?

ACAG does not support this proposal because the:

- proposal is not consistent with IFRS 10, which requires full consolidation of all controlled entities when the controlling entity is not also an investment entity. IFRS 10 requires the parent entity to 'look through' its investment entity subsidiary and consolidate its underlying controlled entities.

Departure from IFRS would seem unnecessary and inconsistent with the IPSASB's own deliberations at BC 18 where they 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."

- proposal means movements in eligible 'investments' of governments will be recorded at fair value through surplus or deficit in the Whole-of-Government (WhOG) accounts. This will include investments governments control indirectly, which substantially extends what was meant to be a limited scope exception to consolidation principles.

  Government Finance Statistics Manual 2013 (GFSM 2013) continues to describe such movements as 'revaluations' rather than 'transactions'. While the fair value of the investments will provide a proxy for market value, the treatment of the gains and losses in consolidated WhOG accounts may require clarification:

  - by the International Monetary Fund,
  - in the GFSM 2013
  - by Treasuries
  - by those with budget responsibilities within jurisdictions adopting IPSAS that these gains and losses are other economic flows for GFS purposes.

- IPSASB notes the types of entities that might qualify as investment entities as "some sovereign wealth funds, some pension funds and some funds holding controlling interests in public-private partnership projects (PPP) or private finance initiatives (PFI)". Governments generally establish these bodies to create long term national wealth and infrastructure capability. At the consolidated level, the annual fair value movement of investments adds or detracts from the nation's wealth, rather than its disposable annual income. Incorporating the annual movement in the investments in the WhOG surplus or deficit, would not increase the usefulness of this information, particularly since it may cause unexpected, unbudgeted fluctuations beyond the control of government or its agencies.

- basis of conclusions to ED 49 notes the IASB's concerns regarding a non-investment controlling entity retaining the fair value treatment used by its controlled investment entities. The IASB supported the 'look through' approach because it considered manipulation of accounting outcomes by structuring the control of an entity either directly or indirectly through an investment entity. The IPSASB considered that this issue was less of a concern in the public sector. However, ACAG does not support this rationale and considers that the potential for manipulation of accounting outcomes through structuring is also present in the public sector. In addition, because governments are not for profit entities, including the changes in fair value of investments within investment entities in the operating result of government will not increase the overall usefulness of those financial statements to users. The departure from the IFRS equivalent does not therefore seem justified.

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?***

Apart from the matter noted at the response to Specific Matter for Comment 5, ACAG is not aware of any further opportunities for alignment.

IPSASB Exposure Draft 52: *Disclosure of Interests in Other Entities* (ED52)

Specific Matter for Comment 1 - *Do you agree the proposed disclosures in this draft Standard? If not, why? Are there any additional disclosures that would be useful for users of financial statements?*

ED 52 is tailored based on IFRS 12 *Disclosure of Interests in Other Entities* and drafted specifically for public sector entities. The disclosures in ED 52 are sufficient and adequate in light of the nature of public sector operations given that any controlled entity by a government department (for example) in most instances is likely to be established via ownership (i.e. equity); and that the likelihood of a structured entity is remote for the purpose of governmental operations.

Having said that, ACAG would like to draw the IPSASB's attention to the divergence from IFRS 12 in respect of the additional disclosures for a non-investment controlling entity in paragraph 34 of ED 52. This divergence arises as a result of ED 49's proposal that a non-investment controlling entity should measure the investments of its controlled investment entities at fair value through surplus or deficit. Consistent with our comments on ED 49 not supporting this proposed divergence, ACAG recommends that paragraph 34 of ED 52 be omitted.

Further, IFRS 12 (paragraph 9A) requires an investment entity to disclose information about significant judgements and assumptions it has made in determining that it is an investment entity. ED 52 (paragraph 15) diverges from this requirement i.e. where the investment entity meets all the characteristics in paragraph 57 of ED 49, the investment entity is not required to disclose its judgements and assumptions in arriving at the conclusion that it is an investment entity. ACAG does not support this divergence and recommends that the IPSASB maintain consistency on the "judgements and assumptions" disclosure for investment entities. For transparency purposes, these disclosures should still be made so that users of financial statements are informed of how the investment entity meets the investment entity criteria.

Specific Matter for Comment 2 - *Do you agree with the proposal that entities for which administrative arrangements or statutory provisions are dominant factors in determining control of the entity are not structured entities? If not, please explain why and explain how you would identify entities in respect of which the structured entity disclosures would be appropriate.*

From a public sector perspective, ACAG agrees that structured entities should not include entities for which administrative arrangements or statutory provisions are dominant factors in determining control of the entity. To include these entities as structured entities would significantly and inappropriately increase disclosure requirements by the public sector given the common practice of establishing entities for administrative functions or by legislative requirements.

Further, ACAG notes that the concept of 'structured entities' is dealt with for the first time in ED 52. No reference is made in ED 49 to such entities. Therefore, ACAG recommends that the IPSASB consider updating ED 52 to clarify that structured entities that meet the control criteria set out in ED 49 are to be consolidated, with the controlled entity disclosures in ED 52 applying to them.