Australian Government
Australian Accounting Standards Board

Level 7, 600 Bourke Street
MELBOURNE VIC 3000
Postal Address
PO Box 204
Collins Street West VIC 8007
Telephone: (03) 9617 7600
Facsimile: (03) 9617 7608

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

Dear Stephenie,

IPSASB Exposure Drafts 48-52 Interests in Other Entities

The Australian Accounting Standards Board (AASB) is pleased to provide comments on the following 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*; and
ED 52 *Disclosure of Interests in Other Entities*

Overall, the AASB is generally supportive of the proposals in the EDs and the move towards convergence with International Financial Reporting Standards (IFRSs), as we consider that differences between IFRSs and IPSASs should be minimised to the extent possible, and divergence should only occur when there are specific public sector reasons for doing so.

However, the AASB has concerns with a number of aspects of the proposals. These areas, which are expanded on in the attached Appendix. We recommend that:

- the definition of power be aligned to that in IFRS 10 *Consolidated Financial Statements* (ED 49);
- controlling entities that are not investment entities should fully consolidate their controlled investment entities (ED 49);
- a retained interest in a former associate or joint venture that becomes a financial asset should be measured at fair value (ED 50); and
- disclosure requirements not be fulfilled by cross-referencing to reports outside the financial statements (ED 52).

The AASB's comments on the Specific Matters for Comment are set out in the attached Appendix.

If you have any queries regarding any matters in this submission, please contact Joanna Spencer (jspencer@aasb.gov.au).

Yours sincerely,

K.M. Stevenson

Kevin M. Stevenson
Chairman and CEO

AASB's Comments on the IPSASB Exposure Draft 48 *Separate Financial Statements*

The AASB's views on the Specific Matter for Comment in ED 48 are as follows:

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?

Whilst the AASB generally disagrees with the use of the equity method for investments in other entities in separate financial statements, on the basis that this method is already permitted in IPSAS 6 *Consolidated and Separate Financial Statements* – we can agree with this proposal.

However, the AASB suggests that the wording in paragraphs 7 and 16 of ED 48 be aligned to the proposed wording in paragraphs 6 and 12 of IASB ED/2013/10 *Equity Method in Separate Financial Statements* (once finalised), to help avoid any confusion and unintended accounting outcomes that are not in line with the principles of the equity method as explained below.

If the ED 48 proposals (and ED 50 *Investments in Associated and Joint Ventures*) become standards without any change to the definition in paragraph 7, there is potential for confusion when identifying separate financial statements of an entity with associates and joint ventures, but no subsidiaries. Consequently, an entity would use the equity method for associates and joint ventures in its financial statements prepared in accordance with ED 50 and could also use the equity method for such investments in separate financial statements.

To help avoid any confusion arising, the AASB suggests that the proposed definition of 'separate financial statements' be amended to be consistent with the definition in paragraph 6 of IASB/2013/10 (once finalised):

> Separate financial statements are those presented in addition to consolidated financial statements or in addition to financial statements of an entity that does not have investments in subsidiaries, ie investor in an associate or joint venture, other than in the circumstances set out in paragraphs 8-8A. Separate financial statements need not be appended to, or accompany those statements.

Paragraph 16 of ED 48 requires a distribution to be recognised in surplus or deficit (directly) regardless of the method used to account for subsidiaries, associates or joint ventures (equity method, cost or fair value). However, if the equity method is used to account for an investment, recognising the distribution directly in surplus or deficit would result in double counting (unless the asset was impaired at the same time) as the entity would recognise its share of surplus or deficit of the investment (from which the dividend is distributed). Under the equity method, when a right to a dividend is established, the carrying amount of the investment is reduced and the current receivables of the investor are increased.

The AASB recommends that paragraph 16 of ED 48 be amended in line with paragraph 12 of IASB/2013/10 (once finalised), which states:

> [A] dividend from a subsidiary, a joint venture or an associate is recognised in the separate financial statements of an entity when the entity's right to receive the dividend is established. The dividend is recognised:
>
> (a) in profit or loss if the entity elects to measure the investment at cost or in accordance with IFRS 9; or
>
> (b) as a reduction from the carrying amount of the investment if the entity elects to use the equity method."

AASB's Comments on the IPSASB Exposure Draft 49 *Consolidated Financial Statements*

The AASB's views on the Specific Matters for Comments (SMC) in ED 49 are as follows:

Specific Matter for Comment 1

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

The AASB agrees with the proposed definition of control.

However, we query the alteration to the definition of 'power' in IFRS 10 *Consolidated Financial Statements* to add the words "including the right to direct the financial and operating policies of that entity". We cannot see any valid reason (including a public sector specific reason) for diverging from the IFRS 10 definition of power.

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.

The AASB agrees that all controlling entities should consolidate controlled entities except for controlling entities that are investment entities. This is the requirement in IFRS 10 and we see no public sector specific reason for divergence.

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).

The AASB strongly agrees with the proposal to withdraw the exemption currently in IPSAS 6 for 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?

The AASB agrees 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. We note that this is consistent with IFRS 10 and do not consider there is any specific public sector reason to have different accounting requirements.

Specific Matter for Comment 5

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

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

The AASB disagrees with the proposal that a controlling entity that is not an investment entity should measure a controlled investment entity's investments at fair value through surplus or deficit. We consider that in such circumstances full consolidation should be required.

The AASB supports the IASB's arguments for requiring consolidation by the controlling entity as explained in the Basis for Conclusions of IFRS 10, particularly the arguments set out below:

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

The AASB responded to IASB ED/2011/4 *Investment Entities* with the view:

> The AASB considers that the parent of an investment entity that is not itself an investment entity should be required to consolidate all of its controlled entities including those it holds through subsidiaries that are investment entities.
>
> The AASB believes that this restriction is essential to help avoid structuring designed to achieve particular accounting outcomes.

> Furthermore, if the exception were to flow up into the consolidated financial statements of the parent, it would be inconsistent with the whole focus of ED/2011/14 on entities that meet the investment entity criteria. That is, the AASB can understand that the accounting for a particular type of transaction or item might flow up into higher levels of a group, but not when the accounting policy depends on the nature of the entity itself.

The AASB noted the IPSASB's arguments in ED 49 for differing from IFRS but disagree that there is any public sector specific reason for doing so.

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?

The AASB has not identified any further opportunities for alignment with the GFSM 2013.

AASB's Comments on the IPSASB Exposure Draft 50 *Investments in Associates and Joint Ventures*

The AASB's views on the Specific Matters for Comments (SMC) in ED 50 are as follows:

Specific Matter for Comment 1 of ED 50

Do you generally agree with the proposals in the Exposure Draft? If not, please provide reasons.

The AASB disagrees with the proposal to measure a retained interest in a former associate or joint venture that becomes a financial asset at the carrying amount as cost. The AASB considers that the proposals in ED 50 should be aligned with those in IAS 28 *Investments in Associates* (as amended 2011) and, therefore, be measured at fair value.

Specific Matter for Comment 2 of ED 50

Do you agree with the proposal that the scope of the Exposure Draft be restricted to situations where there is quantifiable ownership interest?

The AASB is concerned with the departure from the scope of IAS 28 to include the requirement that, for an investment to be recognised, the holding must be of a quantifiable ownership interest. Whilst we understand the arguments for restricting the scope of the proposals in ED 50 to situations where there is a quantifiable ownership interest, we advise caution because other quantifiable economic interests can exist in addition to quantifiable ownership interests. For example, we understand that it is common in the mining industry for an interest in a joint venture to be determined by an entity's rights to output from production. Although the entity will often have shareholders, their purpose is for funding rather than voting. In this scenario an entity's interest in the joint venture is not determined by ownership but by rights to output.

We also note that a similar situation may arise in the public sector whereby an entity may have rights to a percentage of output but does not have ownership of the investment.

We consider that the key requirement in IAS 28 (and therefore the proposals in ED 50) is significant influence. Consequently, we think that the proposal to require a quantifiable ownership interest may result in entities that have significant influence other than through ownership interests not appropriately accounting for their interests in joint ventures or associates.

Specific Matter for Comment 3 of ED 50

Do you agree with the proposal to require the use of the equity method to account for investments in joint ventures? If not, please provide reasons and indicate your preferred treatment.

The AASB agrees with the proposal to use the equity method to account for investments in joint ventures.

AASB's Comments on the IPSASB Exposure Draft 51 *Joint Arrangements*

The AASB's views on the Specific Matters for Comments (SMC) in ED 51 are as follows:

Specific Matter for Comment 1 of ED 51

Do you agree that joint arrangements should be classified as joint ventures or joint operations based on whether an entity has (i) rights to assets and obligations for liabilities, or (ii) rights to net assets?

The AASB agrees that joint arrangements should be classified as joint ventures where the entity has the rights to the net assets and as a joint operation where the entity has rights to assets and obligations for liabilities.

Specific Matter for Comment 2 of ED 51

Do you agree that joint ventures should be accounted for in consolidated financial statements using the equity method?

The AASB agrees that joint ventures should be accounted for in consolidated financial statements using the equity method.

AASB's Comments on the IPSASB Exposure Draft 52 *Disclosure of Interests in Other Entities*

The AASB's views on the Specific Matters for Comments (SMC) in ED 52 are as follows:

Specific Matter for Comment 1 of ED 52

Do you agree [with] the proposed disclosures in this draft Standard? If not, why? Are there any additional disclosures that would be useful for users of financial statements?

Although the AASB acknowledges the proposals in ED 52 are closely aligned with IFRS 12 *Disclosures of Interests in Other Entities*, we have some concerns regarding paragraph 13 of ED 52 which permits some disclosures to be satisfied via a cross-reference to a report that may be outside the financial statements. In some jurisdictions, statements other than financial statements may be outside the standard-setter/regulators authority. Therefore, we suggest either that paragraph be removed, or that it specifies that the use of cross-referencing may be subject to jurisdictional restrictions.

The AASB also disagrees with paragraph 34 of the ED that requires a controlling entity of an investment entity that is not itself an investment entity to disclosure information in respect of unconsolidated investment entities. We consider that all controlling entities that are not investment entities should consolidate all their controlled entities – see our response to SMC 5 of ED 49.

Specific Matter for Comment 2 of ED 52

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.

The AASB agrees with the proposals that entities for which conventional administrative arrangements or statutory provisions are dominant factors in determining control of the entity are not structured entities. We note that the principles proposed are consistent with the AASB's recent amendment to AASB 12 *Disclosure of Interests in Other Entities* to incorporate Australian Implementation Guidance for Not-for-Profit Entities.