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International Public Sector Accounting Standards Board

Submission on Exposure Drafts 48-52

Introduction

1. Auckland Council ("the Council") is the local authority for Auckland, which is New Zealand's largest city and commercial hub. Approximately 1.5 million of New Zealand's total population of approximately 4.5 million reside within the Council's boundaries.
2. The Council has responsibility for local governance activities within its boundaries, including waste collection and disposal, recycling and waste management, parks, sports fields and community facilities, street cleaning, food safety and environmental improvements. The strategic role of the Council is to promote the social, economic, environmental and cultural well-being of Auckland's residents and communities.
3. Subsidiaries of the Council are responsible for the provision of a number of additional services, including water and wastewater services, roads and public transport, property development and economic development.
4. The External Reporting Board, which is responsible for promulgating financial reporting standards in New Zealand, has determined that New Zealand's public sector and not-for-profit entities will report under standards based on International Public Sector Accounting Standards ("IPSAS"), while for-profit entities will continue to report under New Zealand equivalents to International Financial Reporting Standards ("NZ IFRS"). Apart from some very minor New Zealand-specific additional disclosure requirements, NZ IFRS is identical to International Financial Reporting Standards ("IFRS") for for-profit entities. NZ IFRS is largely identical to IFRS for public sector and not-for-profit entities.
5. The Council will adopt standards based on IPSAS in the annual period ending 30 June 2015. The Council currently reports under the requirements of NZ IFRS.
6. The purpose of this submission is to provide the International Public Sector Accounting Standards Board ("the Board") with our comments on ED 48 *Separate Financial Statements*, ED 49 *Consolidated Financial Statements* ("ED 49"), ED 50 *Investments in Associates and Joint Ventures* ("ED 50"), ED 51 *Joint Arrangements* and ED 52 *Disclosure of Interests in Other Entities* (collectively "the EDs"). The Council has a complex group structure and the EDs are consequently of significant relevance to the Council.

General comments

7. The Council is supportive of the Board's stated objective of converging IPSASs, to the extent possible, with IFRS. We consider that IFRSs are developed through a robust process and have been adopted by a significant number of economies and that these factors mean that they form a high quality and well understood base for setting accounting standards for public sector entities.

8. However, we note that public sector entities operate under different objectives, and in different environments, to private sector entities, and that consequently appropriate public sector guidance is required to assist public sector entities with the implementation of IPSAS. We note the Board's inclusion of considerable public sector guidance in the EDs, but consider that, in some instances, additional guidance is required. We suggest that additional guidance is particularly important where the requirements of an IPSAS will differ from the requirements of the IFRS on which it is based.
9. The Council supports the majority of the proposals in the EDs. There are, however, some matters that we consider require further examination. Rather than providing responses to each of the questions in each of the EDs, this submission will focus on those specific issues.

Specific comments

Investment entities

10. The Council's key concern with the EDs relates to the investment entity concept introduced in ED 49.
11. We generally consider that accounting treatment should be based on the substance of the transaction being undertaken, rather than on the nature of the entities undertaking it. This would ordinarily lead us to conclude that an entity should always consolidate another entity in which it holds a controlling interest.
12. However, we also consider that it is fundamentally important that financial statements provide information that users of the financial statements can use to make decisions about their interaction with the preparer of those financial statements.
13. We note that those who invest in the types of entities that would meet the ED 49 definition of an investment entity do so for the capital appreciation and investment return that will be earned on the investments made by the investment entity. We consider that such investors and the management of the investment entity are most likely to have their information needs in relation to those investments met by the provision of information on the fair value of the underlying investments, irrespective of the percentage ownership of such investments. We further note that the consolidation of holdings in underlying investments by investment entities would likely provide information that was not useful to the users of the investment entity's financial statements. Further to this, we note that, if consolidation were required, the users and/or preparers of such financial statements might need to incur additional costs to provide the fair value information sought by investors.
14. On that basis, we agree that entities that invest solely for capital appreciation and/or investment revenue, and that manage investments on a fair value basis, should recognise all of their investments, including those in which they have a controlling interest, at fair value through surplus or deficit in accordance with IPSAS 29 *Financial Instruments: Recognition and Measurement* ("IPSAS 29"). For that reason, we support the proposal in ED 49 to require investment entities to carry their controlling investments in other entities at fair value through surplus or deficit, rather than consolidating such investments.
15. However, we consider that controlled investments should only be carried at fair value when the fair value of an underlying investment can be reliably determined. Where the fair value of an investment that is controlled by an investment entity is unable to be reliably fair valued, we consider that the investment should be consolidated by the investment entity. We do not envisage that such a situation would frequently arise, as the definition of an investment entity includes the requirement that it manage its investments on a fair value basis, which implies that fair value would ordinarily be reliably determinable for such investments.
16. Further to this, we consider that the exception should apply to upstream entities in the group. We do not consider it appropriate to require the parent of an investment entity to consolidate the investment entity's controlling interest in other entities, when the investment entity carries such investments at fair value in its financial statements. We consider that requiring different treatments for the same investment at

different levels in a group undermines the original conclusion that such investments should be carried at fair value through surplus or deficit to provide more relevant and useful information to users of the financial statements.

17. We also consider that the same exception should apply to investments that would ordinarily be accounted for as associates or joint ventures (although we consider that the same requirement for fair value to be reliably determinable that we suggested in relation to controlled entities should apply).
18. We note that ED 50 permits investments held by, or indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust or similar entity, including an investment-linked insurance fund, to be measured at fair value through surplus or deficit in accordance with IPSAS 29. We consider that the requirements of ED 49 and ED 50 should be aligned in relation to this matter. Thus, we consider that ED 50 should refer to investment entities and require recognition of investments made by investment entities at fair value through surplus or deficit, rather than permitting it as an option. We note that, if this is not done, the manner in which an investment is accounted for could change as a result of a very minor change in the percentage of ownership, which we consider would undermine the usefulness of the financial statements. As the definition of an investment entity includes the requirement to manage investments on a fair value basis, if the Board concludes that ED 50 should not be amended in the manner that we have suggested, we consider that an entity should not be classified as an investment entity in ED 49 if it does not take the option in ED 50 to carry investments that would otherwise be classified as associates or joint ventures at fair value through surplus or deficit.
19. Finally, due to the complexity of this issue, the degree of professional judgement required and the potential impact on the financial statements, we consider that additional guidance should be added to the application guidance accompanying ED 49. If the Board concludes that investments by investment entities that would otherwise be accounted for as associates or joint ventures should be carried at fair value through surplus or deficit, we consider that appropriate guidance should also be provided in ED 50.

Temporarily controlled entities

20. The Council is concerned with the inclusion of temporarily controlled entities in ED 49.
21. We consider that there are a limited number of circumstances in which public sector entities are required to invest in other entities to enable them to continue to provide services to the general public. Such investments are driven by public good considerations, rather than by economic considerations. For instance, over the past several years we have seen insurers, financial institutions and airlines purchased by governments for the sole purpose of avoiding the wider economic impacts that would result from the failure of such entities. We note that this situation does not occur in the private sector, where entities are not required to make investments on the basis of public good considerations.
22. Where a public sector entity temporarily takes a majority investment in an entity on the basis of public good considerations, we consider that consolidation is not warranted, as the resultant consolidated financial statements would not reflect the overall purpose of the group and consequently would not provide useful information to users.
23. Although we do not support consolidation of entities that public sector entities temporarily invest in for public good purposes, we do consider that appropriate disclosure is required to enable users of the financial statements to evaluate the impact of such investments. We consider that such disclosure should include the amount of the investment, the percentage ownership of the investee, the reasons for which the investment was made, significant terms and conditions of the investment, future financial support that the investor is likely to be required to provide and the proposed manner and timing of disposal of the investment. Further to this, we consider that disclosure of the financial impacts of such investments should be required. As a minimum, we suggest that information on revenue, expenses, assets, liabilities and contingent liabilities should be included and that significant transactions with, and balances owed to/from, entities in the group that the investee would otherwise be consolidated into should be disclosed.

24. Further to this, we note that entities held for public good reasons can often be difficult to dispose of and that consequently such investments may not be disposed of within the timeframes that would ordinarily be associated with temporary control. In circumstances where control continues for an extended period of time, irrespective of the purpose for which the original investment was made, we consider that consolidation is warranted, because the controlling entity has, either intentionally or by default, accepted the risks and rewards of controlling the investee. We consider that an appropriate timeframe for requiring consolidation would be three years from the date on which control was achieved.
25. Further to this, we consider that such exemptions should apply where equity accounting or proportionate consolidation would ordinarily be required. We consider that such investments should also be excluded from ED 50 on the same basis as we have suggested exclusion from ED 49 (i.e. with adequate disclosure and for a maximum of three years from significant influence or joint control being achieved).

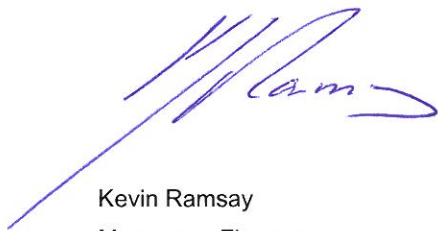
Guidance applicable to trusts

26. Many public sector entities in New Zealand, including the Council, have considerable involvement with trusts. It can be particularly difficult to determine whether control exists in relation to a trust. For that reason, we suggest that the Board consider providing more guidance on the application of the control definition to trusts.

Conclusion

27. The Council supports the EDs, but we consider that the issues identified above need to be addressed.
28. We would be happy to discuss these issues further with the Board if required.
29. If you require any further information, or wish to discuss our comments, please do not hesitate to contact the writer (contact details below), or Angela Chiu (Manager – Group Accounting, Auckland Council) who can be contacted via telephone on +64 21 406 574, or via email at angela.chiu@aucklandcouncil.govt.nz.

Yours faithfully



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