

28 February 2014

Ms Stephenie Fox
The Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
529 Fifth Avenue, 6th Floor
New York, NY 10017 United States of America

Dear Ms Fox

EDs on controlled entities, associates and joint arrangements

The New Zealand Treasury welcomes the opportunity to provide comments to the International

Public Sector Accounting Standards Board on the Exposure Drafts:

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

IPSASB is to be commended for its efforts in developing International Public Sector Accounting Standards (IPSASs) these standards covering issues that are often contentious.


The Treasury particularly applauds the proposed stipulation that a controlling entity should consolidate all controlled entities. It is critical for transparency, accountability and well informed decision making that all controlled entities are incorporated in the consolidated financial statements of a reporting entity.

We have provided one general comment and responses to the specified matters for comment attached.

Yours sincerely



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ATTACHMENT

NZ Treasury response to IPSASB Exposure Drafts matters for comment:

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

General comments

The Treasury strongly supports the IPSASB's strategy to converge IPSASs with IFRSs in developing these particular standards. Most consolidated government financial statements are likely to comprise of groups containing both for profit and not-for-profit groups. It would be disastrous for such consolidations if there were unnecessary differences between the approaches for reporting as a single reporting entity between such sub-groups and the consolidated economic entity.

That however does not mean that appropriately justified differences should not exist. Treasury notes with approval the more stringent requirements on defining an investment entity in the public sector context (and provides suggestions that they be strengthened) as well the approach to investment entity accounting to be "rolled up" in the controlling entity's consolidated financial statements.

Treasury notes that the issue (of differing treatments) is likely to become more prevalent as both IPSAS and IFRS develop. We consider that the requirement of paragraph 34 in ED 49 that ...

a controlling entity shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.

... places not just an onus on preparers, but also an onus on the Board itself to ensure that different requirements are not prescribed for "like transactions and other events in similar circumstances". The corollary is that when the IPSASB sets different requirements than the IASB for recognition or measurement, it must also explain how the transactions, events or circumstances are different, to assist in the judgements required by preparers and auditors in ensuring this requirement is met.

The Treasury recommends this issue be considered in more depth the next time the "Rules of the Road" for harmonising with IFRS are updated.

ED 48 - 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?

Disagree. The Treasury considers the equity method to be a method of consolidation, and therefore inappropriate to be used in non-consolidated financial statements. Also,

the Treasury considers that options should be reduced or eliminated where possible in financial statements. We would however be relaxed about allowing the equity method to be used in the absence of cost information, as a deemed cost amount. This appears to be the main reason for justifying an equity-based approach.

Once initially reported in the financial statements then a cost model, or a revaluation to fair value model should be applied as for other assets.

ED – 49 Specific Matter for Comment 1:

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

Agree – the IPSASB should note that in the public sector context particularly, where entities operate with varying degrees of autonomy, the definition of control requires judgement in its application. In the public sector context, in the application of this judgement, it is likely to be necessary to prepare a list of entities 'deemed' to be controlled by a Government in accordance with these principles. This not only makes transparent the judgements made, but provides necessary clarity for budgeting and reporting purposes. Such "deemed lists" are also critical in managing disputes on which entities should be consolidated. It would be helpful to have recognition that, when such lists are drawn up in accordance with the principles in the standard, they may be considered authoritative.

ED - 49 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.

Agree – it is critical for transparency, accountability and well informed decision making that all controlled entities are incorporated in the consolidated financial statements of a reporting entity.

ED -49: 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).

Agree – Temporary in the public sector, as evidence has shown, can mean a very long time. If the Government has taken control of an entity, it should demonstrate its accountability for it. If the Government takes the view that the results of such entities should be separated from the results of other entities, it should take the segment reporting approach.

The Treasury notes from its experience with taking control over entities in financial distress, that they have been readily able to produce financial statements on a timely basis. The consolidation "cost" can therefore be overstated – systems should not need to change, rather the consolidation process added to.

ED 49: 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?

Agree, so long as the business model is that such entities are managed to maximise fair value, the most relevant information to be used to account for its investments is fair value. Given the expectations of an exit strategy, and restrictions on owners overruling the investment entity's decisions, Treasury would be surprised, and concerned, however if this allowed for strategic profit-making investments, such as Government owned national airlines, to be excluded from consolidation. This point could be made clearer in the Application Guidance.

ED 49: 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?

Agree. The Treasury recognises that this is different to the IASB approach, which appears to have been driven by concerns about manipulation. If an investment entity's accounts are fairly represented through showing its controlled investments at fair values because its purpose is to invest funds from capital appreciation, investment revenue or both, then that reason also applies to the consolidated entity of which the investment entity is a part.

ED 49: 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?

No

ED 50: Specific Matter for Comment 1

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

Agree, with one exception.

The standard aligns with the IFRS definition of an associate being an entity over which the investor has significant influence. However paragraph 10 restricts the application of this standard to only those associates in which an entity holds an ownership interest in the form of a shareholding or other formal equity structure. Such a restriction does not exist in IFRS, and the Treasury disagrees with its introduction of such a restriction for the public sector. It could exclude reporting entities appropriately accounting significantly influenced associates where there is no formal equity structure. Examples include entities where the equity structure is not formalised but the voting structure is.

The IPSASB appears to have, at least partially followed this reasoning, in BC 4 and BC 5. The final sentence of paragraph 10 should therefore be deleted.

ED 50: - Specific Matter for Comment 2

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

Disagree, see above.

ED 50: Specific Matter for Comment 3

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.

Agree

ED 51: Specific Matter for Comment 1:

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?

Agree

ED 51: Specific Matter for Comment 2:

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

Agree

ED 52 - 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?

The Treasury acknowledges the disclosures may be useful. However, we wonder whether the requirements may cause problems.

For example, in New Zealand, Crown entities have been specified in legislation, as has the ability of the Minister of Finance to require the Crown entity to pay to the Crown a sum equal to its net assets. At present 13 Crown entities that have been exempted from this provision. There is therefore a significant restriction in place over the use or access of the Government to these assets controlled by those 13 entities.

Therefore, the New Zealand government would be able, relatively easily to comply with the disclosure required of significant restrictions on the Government's ability to access or use the assets and settle the liabilities of controlled entities. We wonder however, whether, in the absence of such stipulations, such a disclosure could adequately be met in other jurisdictions. We suspect only explicit restrictions could be reported, and not implicit restrictions that may have equal economic substance. We therefore perceive difficulties in requiring this disclosure in the public sector context.

ED 52 - 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.

Agree