Specific Matters for Comment

The IPSASB would particularly value comments on the following questions. It would be helpful to the IPSASB if these comments indicate the specific paragraph number or groups of paragraphs to which they relate, clearly explain the issue and suggest alternative wording, with supporting reasoning, where this is appropriate.

Question 1

Currently, IPSAS 4 does not deal with hedge accounting for foreign currency items other than the classification of certain exchange differences accounted for as a hedge of net investment in a foreign entity. It also notes that guidance on such types of transactions can be found in IAS 39, "Financial Instruments: Recognition and Measurement".

Do you agree that the proposed IPSAS 4 should not apply to derivative transactions and balances that are within the scope of the relevant international and national accounting standards that deal with the recognition and measurement of financial instruments (see paragraph 3(a))?

Question 2

Do you agree with the proposed definition of functional currency as "the currency of the primary economic environment in which the entity operates" and the guidance proposed in paragraphs 11-16 on how to determine what is an entity's functional currency?

Question 3

Do you agree that a reporting entity (whether an economic entity or a stand-alone entity) should be permitted to present its financial statements in any currency (or currencies) that it chooses (see paragraph 42)?

Question 4

Do you agree that all entities should translate their financial statements into the presentation currency (or currencies) using the same method as is required for translating a foreign operation for inclusion in the entity's financial statements (see paragraphs 43 and 47)?

Question 5

Paragraph 31 in IPSAS 4 currently requires the following:

31. Exchange differences may result from a severe devaluation or depreciation of a currency against which there is no practical means of hedging and that affects liabilities which cannot be settled and which arise directly on the recent acquisition of an asset invoiced in a foreign currency. Such exchange differences should be included in the carrying amount of the related asset.

Do you agree that the allowed alternative to capitalize certain exchange differences as currently described in paragraph 31 of proposed IPSAS 4 should be removed?

Question 6

Do you agree that goodwill and fair value adjustments to assets and liabilities that arise on the acquisition of a foreign operation should be treated as assets and liabilities of the foreign operation and translated at the closing rate (see paragraph 55)?

SUMMARY OF MAIN CHANGES IPSAS 4
THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

The main changes proposed are:

Scope

- to now exclude in paragraph 3 foreign currency derivatives that are within the scope of international or national accounting standards that address the recognition and measurement of financial instruments. (Hedge accounting that was previously excluded in IPSAS 4 will remain excluded in IPSAS 4 because it is a form of derivative.)

Definitions

- to replace the term ‘reporting currency’ with two notions (in paragraph 10):
  - functional currency–currency of the primary economic environment in which the entity operates
  - presentation currency–currency in which the financial statements are presented
- to modify the definitions in paragraph 10 the terms: “exchange difference”, “foreign currency”, and “net investment in a foreign operation”

Functional Currency

- to require each reporting entity to determine its functional currency and measure its results and financial position in that currency in paragraphs 24 and 26. Consequently, the entity:
  - does not have a free choice of functional currency (paragraphs 11-16); and
  - cannot avoid restatement when reporting in a hyperinflationary economy (paragraphs 16, 47-48).
- to disclose the functional currency of the entity when the functional currency is different from its presentation currency and to clarify why in paragraph 61.
- to disclose when there has been a change in functional currency, and the reasons for the change in paragraph 62.
- to replace the previous requirement to account for a change in the classification of a foreign operation with a requirement that a change in functional currency is accounted for prospectively in paragraph 39.

Integral Foreign Operations vs Foreign Entities

- to eliminate the distinction between integral foreign operations and foreign entities. Consequently an entity that was previously classified as an integral foreign operation will have the same functional currency as the reporting entity only one translation method is used.

Reporting Foreign Currency Transactions in the Functional Currency - Recognition of Exchange Differences

- to remove the allowed alternative treatment where an entity can capitalize exchange differences resulting from a severe devaluation or depreciation of a currency against which there is no means of hedging. Now, the Standard requires that such exchange differences, where applicable, be reflected in the surplus or deficit in paragraph 31.

Use of a Presentation Currency other than the Functional Currency

- to clarify in paragraph 42 that this Standard permits an entity to present its financial statements in any currency (or currencies).

- to require that goodwill and fair value adjustments to assets and liabilities that arise on the acquisition of a foreign entity only be treated as part of the assets and liabilities of the acquired entity and translated at the closing rate in paragraph 55. Previously, an entity was also allowed to treat these types of goodwill and fair value adjustments as assets and liabilities of the reporting entity. This paragraph has also changed to bold type from a commentary paragraph.

Disclosure

- to require in paragraph 65 that when the entity discloses financial information where the presentation currency is not its functional currency and the translation method does not comply with each applicable IPSAS, the entity shall:

    - clearly identify the information as supplementary information to distinguish it from other information that complies with IPSASs;

    - disclose the currency in which supplementary information is displayed; and

    - disclose the entity's functional currency and the method of translation used to determine the supplementary information.

Transitional Provisions

- to allow first-time adopters of IPSASs in paragraph 67 to deem the cumulative translation differences that existed at the date they first adopt IPSASs as zero.

- to provide a new transitional provision in paragraph 68 for those entities which previously applied the eliminated alternative treatment for goodwill and fair value adjustments arising on the acquisition of a foreign operation. An entity, on first application of this Standard, is allowed to apply prospectively these types of goodwill and fair value adjustments in accordance to the new requirements in this Standard. (Retrospective application is allowed.)

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD 4—THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

CONTENTS

DRAFT IPSAS 4

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD 4

THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

International Public Sector Accounting Standard 4, “The Effects of Changes in Foreign Exchange Rates” (IPSAS 4) is set out in paragraphs 1-74 and the Appendix. All the paragraphs have equal authority. IPSAS 4 should be read in the context of its objective, the Basis for Conclusion (if any), and the “Preface to the International Public Sector Accounting Standards”. IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD 4—THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

Objective

1. An entity may carry on foreign activities in two ways. It may have transactions in foreign currencies or it may have foreign operations. In addition, an entity may present its financial statements in a foreign currency. The objective of this Standard is to prescribe how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a presentation currency.

2. The principal issues are which exchange rate(s) to use and how to report the effects of changes in exchange rates in the financial statements.

Scope

3. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard:**

   (a) **in accounting for transactions and balances in foreign currencies, except for those derivative transactions and balances that are within the scope of international and national accounting standards that deal with the recognition and measurement of financial instruments;**

   (b) **in translating the results and financial position of foreign operations that are included in the financial statements of the entity by consolidation, proportionate consolidation or by the equity method; and**

   (c) **in translating an entity's results and financial position into a presentation currency.**

4. International and national accounting standards dealing with the recognition and measurement of financial instruments apply to many currency derivatives and, these are excluded from the scope of this Standard. However, those foreign currency derivatives that are not within the scope of those international and national accounting standards (eg some foreign currency derivatives that are embedded in other contracts) are within the scope of this Standard. In addition, this Standard applies when an entity translates amounts relating to derivatives from its functional currency to its presentation currency.

5. This Standard does not apply to hedge accounting for foreign currency items including the hedging of a net investment in a foreign operation. Accordingly, entities may apply relevant international or national accounting standards dealing with hedge accounting.

6. **This Standard applies to all public sector entities other than Government Business Enterprises.**

7. The "Preface to International Public Sector Accounting Standards" issued by the International Public Sector Accounting Standards Board (IPSASB) explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) which are issued by the International Accounting Standards Board (IASB). GBEs are defined in IPSAS 1, "Presentation of Financial Statements".

8. This Standard applies to the presentation of an entity's financial statements in a foreign currency and sets out requirements for the resulting financial statements to be described as complying with International Public Sector Accounting Standards. For translations of financial information into a foreign currency that do not meet these requirements, this Standard specifies information to be disclosed.

9. This Standard applies to the presentation of revenue and expenses arising from transactions in a foreign currency and translating the financial statements of a foreign operation. It does not apply to the presentation in a cash flow statement of cash flows arising from transactions in a foreign currency or to the translation of cash flows of a foreign operation (see International Public Sector Accounting Standard IPSAS 2, "Cash Flow Statements").

Definitions

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

Closing rate is the spot exchange rate at the reporting date.

Economic entity means a group of entities comprising a controlling entity and one or more controlled entities.

Exchange difference is the difference resulting from translating a given number of units of one currency into another currency at different exchange rates.

Exchange rate is the ratio of exchange for two currencies.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Foreign currency is a currency other than the functional currency of the entity.

Foreign operation is an entity that is a controlled entity, associate, joint venture or branch of a reporting entity, the activities of which are based or conducted in a country other than those of the reporting entity.

Functional currency is the currency of the primary economic environment in which the entity operates.

Monetary items are units of currency held and assets and liabilities to be received or paid in fixed or determinable number of units of currency.

Net investment in a foreign operation is the amount of the reporting entity's interest in the net assets/equity of that operation.

Presentation currency is the currency in which the financial statements are presented.

Spot exchange rate is the exchange rate for immediate delivery.

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

Elaboration on the Definitions

Functional Currency

11. The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash. An entity considers the following factors in determining its functional currency:

    (a) the currency:

        (i) that revenue is raised from, such as taxes, grants, and fines;

        (ii) that mainly influences sales prices for goods and services (this will often be the currency in which sales prices for its goods and services are denominated and settled); and

        (ii) of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.

    (b) the currency that mainly influences labor, material and other costs of providing goods and services (this will often be the currency in which such costs are denominated and settled).

12. The following factors may also provide evidence of an entity's functional currency:

    (a) the currency in which funds from financing activities (ie issuing debt and equity instruments) are generated.

    (b) the currency in which receipts from operating activities are usually retained.

13. The following additional factors are considered in determining the functional currency of a foreign operation, and whether its functional currency is the same as that of the reporting entity (the reporting entity, in this context, being the entity that has the foreign operation as its controlled entity, branch, associate or joint venture):

    (a) whether the activities of the foreign operation are carried out as an extension of the reporting entity, rather than being carried out with a significant degree of autonomy. An example of the former is when a department of defense has a number of overseas bases which conduct activities on behalf of a national government. The defense bases might conduct their activities substantially in the functional currency of the reporting entity. For example, military personnel may be paid in the functional currency and receive only a small allowance in local currency. Purchases of supplies and equipment might be largely obtained via the reporting entity with purchases in local currency being kept to a minimum. Another example would be an overseas campus of a public university which operates under the management and direction of the domestic campus. In contrast, a foreign operation with a significant degree of autonomy may accumulate cash and other monetary items, incurs expenses, generates revenue and perhaps arranges borrowings, all substantially in its local currency. Some examples of government-owned foreign operations which may operate independently of other government agencies include tourist offices, petroleum exploration companies, trade boards and broadcasting operations. Such entities may be established as Government Business Enterprises. When there is a change in the exchange rate between the functional currency and the local currency, there is little or no direct effect on the present and future cash flows from operations of either the foreign operation or the reporting entity. The change in the exchange rate affects the reporting entity's net investment in the foreign operation rather than the individual monetary and non-monetary items held by the foreign operation.

    (b) whether transactions with the reporting entity are a high or a low proportion of the foreign operation's activities.

(c) whether cash flows from the activities of the foreign operation directly affect the cash flows of the reporting entity and are readily available for remittance to it.

(d) whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligations without funds being made available by the reporting entity.

14. When the above indicators are mixed and the functional currency is not obvious, management uses its judgment to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and conditions. As part of this approach, management gives priority to the primary indicators in paragraph 11 before considering the indicators in paragraphs 12 and 13, which are designed to provide additional supporting evidence to determine an entity's functional currency.

15. An entity's functional currency reflects the underlying transactions, events and conditions that are relevant to it. Accordingly, once determined, the functional currency is not changed unless there is a change in those underlying transactions, events and conditions.

16. If the functional currency is the currency of a hyperinflationary economy, the entity's financial statements are restated in accordance with IPSAS 10, "Financial Reporting Hyperinflationary Economies". An entity cannot avoid restatement in accordance with IPSAS 10 by, for example, adopting as its functional currency a currency other than the functional currency determined in accordance with this Standard (such as the functional currency of its controlling entity).

Monetary Items

17. The essential feature of a monetary item is a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: social policy obligations and other employee benefits to be paid in cash; provisions that are to be settled in cash, and cash dividends that are recognized as a liability. Conversely, the essential feature of a non-monetary item is the absence of a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: amounts prepaid for goods and services (eg prepaid rent); goodwill; intangible assets; inventories; property, plant and equipment; and provisions that are to be settled by the delivery of a non-monetary asset.

Net Investment in a Foreign Operation

18. An entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely

to occur in the foreseeable future is, in substance, a part of the entity's net investment in that foreign operation, and is accounted for in accordance with paragraphs 35 and 36. Such monetary items may include long-term receivables or loans. They do not include trade receivables and trade payables.

Summary of the Approach Required by this Standard

19. In preparing financial statements, each entity–whether a stand-alone entity, an entity with foreign operations (such as a controlling entity) or a foreign operation (such as a controlled entity or branch)–determines its functional currency in accordance with paragraphs 11-15. The entity translates foreign currency items into its functional currency and reports the effects of such translation in accordance with paragraphs 22 –40 and 58.

20. Many reporting entities comprise a number of individual entities (eg an economic entity is made up of a controlling entity and one or more controlled entities). Various types of entities, whether members of an economic entity or otherwise, may have investments in associates or joint ventures. They may also have branches. It is necessary for the results and financial position of each individual entity included in the reporting entity to be translated into the currency in which the reporting entity presents its financial statements. This Standard permits the presentation currency of a reporting entity to be any currency (or currencies). The results and financial position of any individual entity within the reporting entity whose functional currency differs from the presentation currency are translated in accordance with paragraphs 42-58.

21. This Standard also permits a stand-alone entity preparing financial statements or an entity preparing separate financial statements in accordance with IPSAS 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 results and financial position are also translated into the presentation currency in accordance with paragraphs 42-58.

Reporting Foreign Currency Transactions in the Functional Currency

Initial Recognition

22. A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity:

    (a) buys or sells goods or services whose price is denominated in a foreign currency;

(b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or

(c) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

23. **A foreign currency transaction shall be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.**

24. The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with International Public Sector Accounting Standards. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

25. Exchange rate changes may have an impact on cash or cash equivalents held or due in a foreign currency. The presentation of such exchange differences is dealt with in IPSAS 2. Although these changes are not cash flows, the effect of exchange rate changes on cash or cash equivalents held or due in a foreign currency are reported in the cash flow statement in order to reconcile cash and cash equivalents at the beginning and the end of the period. These amounts are presented separately from cash flows from operating, investing and financing activities and include the differences, if any, had those cash flows been reported at end-of-period exchange rates.

Reporting at Subsequent Reporting Dates

26. **At each reporting date:**

(a) **foreign currency monetary items shall be translated using the closing rate;**

(b) **non-monetary items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction; and**

(c) **non-monetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date when the fair value was determined.**

27. The carrying amount of an item is determined in conjunction with other relevant International Public Sector Accounting Standards. For example, property, plant and equipment may be measured in terms of fair value or

historical cost in accordance with IPSAS 17, "Property, Plant and Equipment". Whether the carrying amount is determined on the basis of historical cost or on the basis of fair value, if the amount is determined in a foreign currency it is then translated into the functional currency in accordance with this Standard.

28. The carrying amount of some items is determined by comparing two or more amounts. For example, the carrying amount of inventories held for sale is the lower of cost and net realizable value in accordance with IPSAS 12, "Inventories". Similarly, in accordance with IPSAS 21, "Impairment of Non-Cash-Generating Assets", the carrying amount of a non-cash generating asset for which there is an indication of impairment is the lower of its carrying amount before considering possible impairment losses and its recoverable service amount. When such an asset is non-monetary and is measured in a foreign currency, the carrying amount is determined by comparing:

    (a) the cost or carrying amount, as appropriate, translated at the exchange rate at the date when that amount was determined (ie the rate at the date of the transaction for an item measured in terms of historical cost); and

    (b) the recoverable service amount, as appropriate, translated at the exchange rate at the date when that value was determined (eg the closing rate at the reporting date).

    The effect of this comparison may be that an impairment loss is recognized in the functional currency but would not be recognized in the foreign currency, or vice versa.

29. When several exchange rates are available, the rate used is that at which the future cash flows represented by the transaction or balance could have been settled if those cash flows had occurred at the measurement date. If exchangeability between two currencies is temporarily lacking, the rate used is the first subsequent rate at which exchanges could be made.

Recognition of Exchange Differences

30. As noted in paragraph 3, this Standard does not deal with hedge accounting for foreign currency items. Guidance in relation to other aspects of hedge accounting, including the criteria to use hedge accounting, can be found in international or national accounting standards that deal with measurement and recognition of financial instruments. .

31. **Exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous financial statements shall be recognized in surplus or deficit in the period in which they arise, except as described in paragraph 35.**

32. When monetary items arise from a foreign currency transaction and there is a change in the exchange rate between the transaction date and the date of settlement, an exchange difference results. When the transaction is settled within the same accounting period as that in which it occurred, all the exchange difference is recognized in that period. However, when the transaction is settled in a subsequent accounting period, the exchange difference recognized in each period up to the date of settlement is determined by the change in exchange rates during each period.

33. The treatment of foreign currency exchange rate changes in a cash flow statement is described in paragraph 24.

34. **When a gain or loss on a non-monetary item is recognized directly in net assets/equity, any exchange component of that gain or loss shall be recognized directly in net assets/equity. Conversely, when a gain or loss on a non-monetary item is recognized in surplus or deficit, any exchange component of that gain or loss shall be recognized in surplus or deficit.**

35. Other Standards require some gains and losses to be recognized directly in net assets/equity. For example, IPSAS 17 requires some gains and losses arising on a revaluation of property, plant and equipment to be recognized directly in net assets/equity. When such an asset is measured in a foreign currency, paragraph 26(c) of this Standard requires the revalued amount to be translated using the rate at the date the value is determined, resulting in an exchange difference that is also recognized in net assets/equity.

36. **Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation (see paragraph 18) shall be recognized in surplus or deficit in the separate financial statements of the reporting entity or the individual financial statements of the of the foreign operation, as appropriate. In the financial statements that include the foreign operation and the reporting entity (eg consolidated financial statements when the foreign operation is a controlled entity), such exchange differences shall be recognized initially in a separate component of net assets/equity and recognized in surplus or deficit on disposal of the net investment in accordance with paragraph 56.**

37. When a monetary item forms part of a reporting entity's net investment in a foreign operation and is denominated in the functional currency of the reporting entity, an exchange difference arises in the foreign operation's individual financial statements in accordance with paragraph 30. Similarly, if such an item is denominated in the functional currency of the foreign operation, an exchange difference arises in the reporting entity's separate

financial statements in accordance with paragraph 30. Such exchange differences are reclassified to the separate component of net assets/equity in the financial statements that include the foreign operation and the reporting entity (ie financial statements in which the foreign operation is consolidated, proportionally consolidated or accounted for using the equity method). However, a monetary item that forms part of the reporting entity's net investment in a foreign operation may be denominated in a currency other than the functional currency of either the reporting entity or the foreign operation. The exchange differences that arise on translating the monetary item into the functional currencies of the reporting entity and the foreign operation are not reclassified to the separate component of net assets/equity in the financial statements that include the foreign operation and the reporting entity (ie they remain recognized in surplus or deficit).

38. When an entity keeps its books and records in a currency other than its functional currency, at the time the entity prepares its financial statements all amounts are translated into the functional currency in accordance with paragraphs 22-29. This produces the same amounts in the functional currency as would have occurred had the items been recorded initially in the functional currency. For example, monetary items are translated into the functional currency using the closing rate, and non-monetary items that are measured on a historical cost basis are translated using the exchange rate at the date of the transaction that resulted in their recognition.

Change in Functional Currency

39. **When there is a change in an entity's functional currency, the entity shall apply the translation procedures applicable to the new functional currency prospectively from the date of the change.**

40. As noted in paragraph 14, the functional currency of an entity reflects the underlying transactions, events and conditions that are relevant to the entity. Accordingly, once the functional currency is determined, it can be changed only if there is a change to those underlying transactions, events and conditions. For example, a change in the currency that mainly influences the sales prices or the provision of goods and services may lead to a change in an entity's functional currency.

41. The effect of a change in functional currency is accounted for prospectively. In other words, an entity translates all items into the new functional currency using the exchange rate at the date of the change. The resulting translated amounts for non-monetary items are treated as their historical cost. Exchange differences arising from the translation of a foreign operation previously classified in net assets/equity in accordance with paragraphs 35 and 42(c) are not recognized in surplus or deficit until the disposal of the operation.

Use of a Presentation Currency other than the Functional Currency

Translation to the Presentation Currency

42. An entity may present its financial statements in any currency (or currencies). If the presentation currency differs from the entity's functional currency, it translates its results and financial position into the presentation currency. For example, when an economic entity contains individual entities with different functional currencies, the results and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented.

43. **The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:**

    (a) **assets and liabilities for each statement of financial position presented (ie including comparatives), shall be translated at the closing rate at the date of that statement of financial position;**

    (b) **revenue and expenses for each statement of financial performance (ie including comparatives) shall be translated at exchange rates at the dates of the transactions; and**

    (c) **all resulting exchange differences shall be recognized as a separate component of net assets/equity.**

44. In translating the cash flows, that is the cash receipts and cash payments, of a foreign operation for incorporation in its cash flow statement, the reporting entity shall comply with the procedures in IPSAS 2. IPSAS 2 requires that the cash flows of a controlled entity which satisfies the definition of a foreign operation shall be translated at the exchange rates between the reporting currency and the foreign currency at the dates of the cash flows. IPSAS 2 also outlines the presentation of unrealized gains and losses arising from changes in foreign currency exchange rates on cash and cash equivalents held or due in a foreign currency.

45. For practical reasons, a rate that approximates the exchange rates at the dates of the transactions, for example an average rate for the period, is often used to translate revenue and expense items. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

46. The exchange differences referred to in paragraph 42(c) result from:

    (a) translating revenue and expenses at the exchange rates at the dates of the transactions and assets and liabilities at the closing rate. Such exchange differences arise both on revenue and expense items recognized in surplus and deficit and on those recognized directly in net assets/equity.

(b) translating the opening net assets/equity at a closing rate that differs from the previous closing rate.

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, the minority interest in the consolidated statement of financial position.

47. **The results and financial position of an entity whose functional currency is the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:**

(a) **all amounts (ie assets, liabilities, net assets/equity items, revenue and expenses, including comparatives) shall be translated at the closing rate at the date of the most recent statement of financial position, except that**

(b) **when amounts are translated into the currency of a non-hyperinflationary economy, comparative amounts shall be those that were presented as current year amounts in the relevant prior year financial statements (ie not adjusted for subsequent changes in the price level or subsequent changes in exchange rates).**

48. **When an entity's functional currency is the currency of a hyperinflationary economy, the entity shall restate its financial statements in accordance with IPSAS 10, "Financial Reporting in Hyperinflationary Economies" before applying the translation method set out in paragraph 47, except for comparative amounts that are translated into a currency of a non-hyperinflationary economy (see paragraph 47(b). When the economy ceases to be hyperinflationary and the entity no longer restates its financial statements in accordance with IPSAS 10, it shall use as the historical costs for translation into the presentation currency the amounts restated to the price level at the date the entity ceased restating its financial statements.**

Translation of a Foreign Operation

49. Paragraphs 49-54, in addition to paragraphs 42-48, apply when the results and financial position of a foreign operation are translated into a presentation currency so that the foreign operation can be included in the financial

statements of the reporting entity by consolidated, proportional consolidation or the equity method.

50. The incorporation of the results 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 and International Public Sector Accounting Standard (IPSAS) 8, "Financial Reporting of Interests in Joint Ventures").

51. However, a monetary item within an economic entity, whether short-term or long-term, cannot be eliminated against the corresponding liability (or asset) within an economic entity without showing the results of currency fluctuations in the consolidated financial statements. This is because the monetary item represents a commitment to convert one currency into another and exposes the reporting entity to a gain or loss through currency fluctuations. Accordingly, in the consolidated financial statements of the reporting entity, such an exchange difference continues to be recognized in surplus or deficit or, if it arises from the circumstances described in paragraph 35, it is classified as net assets/equity until the disposal of the foreign operation.

52. 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 6 allows the use of a different reporting date provided that the difference is no greater than three months and adjustments are made for the effects of any significant transactions or other events that occur between the different dates.

53. When there is a difference between the reporting date of the reporting entity and the foreign operation, the assets and liabilities of the foreign operation are translated at the exchange rate at the reporting date of the foreign operation.

54. Adjustments are made for significant changes in exchange rates up to the reporting date of the reporting entity in accordance with IPSAS 6. The same approach is used in applying the equity method to associates and joint ventures and in applying proportionate consolidation in joint ventures in accordance with International Public Sector Accounting Standard (IPSAS) 7, "Accounting for Investments in Associates" and IPSAS 8.

55. **Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation shall be treated as assets and liabilities of the foreign operation. Thus they shall be**

expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraphs 42 and 47.

Disposal of a Foreign Operation

56. **On the disposal of a foreign operation, the cumulative amount of the exchange differences deferred in the separate component of net assets/equity relating to that foreign operation shall be recognized in surplus or deficit when the gain or loss on disposal is recognized.**

57. An entity may dispose of its interest in a foreign operation through sale, liquidation, repayment of contributed capital, or abandonment of all, or part of, that entity. The payment of a dividend is part of a disposal only when it constitutes a return of the investment, for example when the dividend is paid out of pre-acquisition surplus. In the case of a partial disposal, only the proportionate share of the related accumulated exchange difference is included in the gain or loss. A write-down of the carrying amount of a foreign operation does not constitute a partial disposal. Accordingly, no part of the deferred foreign exchange gain or loss is recognized in surplus or deficit at the time of a write-down.

Tax Effects of Exchange Differences

58. For reporting entities subject to income taxes, guidance on the treatment of tax effects associated with the gains and losses on foreign currency transactions and exchange differences arising on translating the results and financial position of an entity (including foreign operation) into a different currency can be found in international or national accounting standards dealing with income taxes.

Disclosure

59. **In paragraphs 61 and 62-64 references to 'functional currency' apply, in the case of an economic entity, to the functional currency of the controlling entity.**

60. **The entity shall disclose:**

    (a) **the amount of exchange differences recognized in surplus or deficit except for those arising on financial instruments measured at fair value through surplus or deficit in accordance with international or national accounting standards that deal with the recognition and measurement of financial instruments; and**

    (b) **net exchange differences classified in a separate component of net assets/equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.**

61. **When the presentation currency is different from the functional currency, that fact shall be stated, together with disclosure of the functional currency and the reason for using a different presentation currency.**

62. **When there is a change in the functional currency of either the reporting entity or a significant foreign operation, that fact and the reason for the change in functional currency shall be disclosed.**

63. **When an entity presents its financial statements in a currency that is different from its functional currency, it shall describe the financial statements as complying with International Public Sector Accounting Standards only if they comply with all the requirements of each applicable Standard including the translation method set out in paragraphs 42 and 47.**

64. An entity sometimes presents its financial statements or other financial information in a currency that is not its functional currency without meeting the requirements of paragraph 62. For example, an entity may convert into another currency only selected items from its financial statements. Or, an entity whose functional currency is not the currency of a hyperinflationary economy may convert the financial statements into another currency by translating all items at the most recent closing rate. Such conversions are not in accordance with International Public Sector Accounting Standards and the disclosures set out in paragraph 64 are required.

65. **When an entity displays its financial statements or other financial information in a currency that is different from either its functional currency or its presentation currency and the requirements of paragraph 62 are not met, it shall:**

    (a) **clearly identify the information as supplementary information to distinguish it from the information that complies with International Public Sector Accounting Standards;**

    (b) **disclose the currency in which the supplementary information is displayed; and**

    (c) **disclose the entity's functional currency and the method of translation used to determine the supplementary information.**

Transitional Provisions

Initial Adoption of Accrual Accounting

66. **A reporting entity need not comply with the requirements for cumulative translation differences that existed at the date of first adoption of accrual accounting in accordance with International Public Sector Accounting Standards (IPSASs). If a first-time adopter uses this exemption:**

    (a) **the cumulative translation differences for all foreign operations are deemed to be zero at the date of first adoption to IPSASs; and**

    (b) **the gain and loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of first adoption to IPSASs, and shall include later translation differences.**

67. This Standard requires entities to:

    (a) classify some translation differences as a separate component of net assets/equity; and

    (b) on disposal of a foreign operation, to transfer the cumulative translation difference for that foreign operation to the statement of financial performance as part of the gain or loss on disposal.

    The transitional provisions provide first-time adopters of IPSASs with relief from this requirement.

Transitional Provisions for All Entities

68. **An entity shall apply paragraph 54 prospectively to all acquisitions occurring after the beginning of the financial reporting period in which this International Public Sector Accounting Standard is first applied. Retrospective application of paragraph 54 to earlier acquisitions is permitted. For an acquisition of a foreign operation treated prospectively but which occurred before the date on which this Standard is first applied, the entity shall not restate prior years and accordingly may, when appropriate, treat goodwill and fair value adjustments arising on that acquisition as assets and liabilities of the entity rather than as assets and liabilities of the foreign operation. Therefore, those goodwill and fair value adjustments either are already expressed in the entity's functional currency or are non-monetary foreign currency items, which are reported using the exchange rate at the date of the acquisition.**

69. **All other changes resulting from the application of this International Public Sector Accounting Standard shall be accounted for in accordance**

with the requirements of IPSAS 3, "Accounting Policies, Changes in Accounting Estimates and Errors".

Effective Date

70. **An entity shall apply this International Public Sector Accounting Standard for annual periods beginning on or after DD MM YYYY. Earlier application is encouraged. If an entity applies this Standard for a period beginning before DD MM YYYY, it shall disclose that fact**

71. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, 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 4 (issued 2000)

72. This Standard supersedes IPSAS 4, "The Effects of Changes in Foreign Exchange Rates" issued in 2000.

Appendix

Amendments to Other Pronouncements

The amendments in this appendix shall be applied for annual periods beginning on or after DD MM YYYY. If an entity applies this Standard for an earlier period, these amendments shall be applied for that earlier period.

A1. In IPSAS 2, "Cash Flow Statements", paragraphs 36 and 37 are amended to read as follows:

36. **Cash flows arising from transactions in a foreign currency ~~should~~shall be recorded in an entity's ~~reporting~~functional currency by applying to the foreign currency amount the exchange rate between the ~~reporting~~functional currency and the foreign currency at the date of the cash flow.**

37. **The cash flows of a foreign controlled entity ~~should~~shall be translated at the exchange rates between the ~~reporting~~functional currency and the foreign currency at the dates of the cash flows.**

A2. IPSAS 10, "Financial Reporting in Hyperinflationary Economies" is amended as described below:

Paragraph 1 is amended to read as follows:

1. **An entity which prepares and presents financial statements under the accrual basis of accounting ~~should~~shall apply this Standard to the ~~primary~~individual financial statements, including the consolidated financial statements, of any entity ~~that reports~~whose functional currency is ~~in~~ the currency of a hyperinflationary economy.**

Paragraph 11 is amended to read as follows:

11. **The financial statements of an entity ~~that reports~~whose functional currency is ~~in~~ the currency of a hyperinflationary economy ~~should~~shall be stated in terms of the measuring unit current at the reporting date. The corresponding figures for the previous period required by International Public Sector Accounting Standard IPSAS 1, "Presentation of Financial Statements", and any information in respect of earlier periods, ~~should~~shall also be stated in terms of the measuring unit current at the reporting date. For the purpose of presenting comparative amounts in a different presentation currency, paragraphs 47(b) and 48 of International Public Sector Accounting Standard IPSAS 4, "The Effects of Changes in Foreign Exchange Rates" apply.**

DRAFT IPSAS 4

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD 4
THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

Paragraph 20 is amended to read as follows:

20. A general price index may not be available for the periods for which the restatement of property, plant and equipment is required by this Standard. In these ~~rare~~ circumstances, it may be necessary to use an estimate based, for example, on the movements in the exchange rate between the ~~reporting~~functional currency and a relatively stable foreign currency.

Paragraph 26 is deleted.

Paragraph 33 is amended to read as follows:

33. Corresponding figures for the previous reporting period, whether they were based on a historical cost approach or a current cost approach, are restated by applying a general price index so that the comparative financial statements are presented in terms of the measuring unit current at the end of the reporting period. Information that is disclosed in respect of earlier periods is also expressed in terms of the measuring unit current at the end of the reporting period. For the purpose of presenting comparative amounts in a different presentation currency, paragraphs 47(b) and 48 of IPSAS 4, "The Effects of Changes in Foreign Exchange Rates" apply.

Paragraph 38 is amended to read as follows:

38. **The following disclosures ~~should~~shall be made:**

(a) **the fact that the financial statements and the corresponding figures for previous periods have been restated for the changes in the general purchasing power of the ~~reporting~~functional currency and, as a result, are stated in terms of the measuring unit current at the reporting date; and…**

Table of Concordance

This table shows how the contents of the current version of IPSAS 4 and the proposed version of IPSAS 4 correspond. Paragraphs are treated as corresponding if they broadly address the same matter even though the guidance may differ.

Current IPSAS 4 paragraphs	Proposed IPSAS 4 paragraph
Objective	1, 2
1	3
2	4, 5
3	None
4	6
5	7
6	8
7	None
8	9
9	10
10	None
11	None
12	None
13	None
14	None
15	None
16	22
17	23
18	24
19	25
20	26
21	27
22	None
23	30
24	31
25	32
26	33
27	36
28	18
29	None
30	None
31	None
32	None
33	None
34	13
35	13
36	13
37	None
38	None
39	None
40	None
41	43
42	None
43	44
44	45
45	46
46	55
47	50
48	51
49	52
50	53
51	54
52	48
53	None
54	None
55	56
56	57
57	None
58	None
59	None
60	58
61	60
62	61, 62
63	None
64	None
65	None
66	68, 69
67	70
68	71
None	11
None	12
None	14-16
None	17, 19-21
None	28, 29
None	34, 35
None	37-42
None	47
None	50
None	59
None	63-65
None	66-67
None	72

Comparison with IAS 21

International Public Sector Accounting Standard IPSAS 4, "The Effects of Changes in Foreign Exchange Rates" is drawn primarily from International Accounting Standard IAS 21, "The Effects of Changes in Foreign Exchange Rates" (2003). The main differences between IPSAS 4 and IAS 21 are as follows:

- Commentary additional to that in IAS 21 has been included in IPSAS 4 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 4 uses different terminology, in certain instances, from IAS 21. The most significant examples are the use of the terms "revenue", "statement of financial performance", "statement of financial position" and "net assets/equity" in IPSAS 4. The equivalent terms in IAS 21 are "income", "income statement", "balance sheet" and "equity".
- IPSAS 4 contains a different set of definitions of technical terms from IAS 21 (paragraph 10).
- IPSAS 4 contains an additional transitional provision allowing an entity, when first adopting IPSASs to deem cumulative translation differences existing at the date of first adoption of accrual IPSASs as zero. (paragraph 66) This transitional provision is adapted from IFRS 1, "First-time Adoption of International Financial Reporting Standards".

Specific Matters for Comment

The IPSASB would particularly value comments on the following questions. It would be helpful to the IPSASB if these comments indicate the specific paragraph number or groups of paragraphs to which they relate, clearly explain the issue and suggest alternative wording, with supporting reasoning, where this is appropriate.

Question 1

Do you agree that a controlling entity need not prepare consolidated financial statements if all the criteria in paragraph 16 are met?

Question 2

Do you agree that minority interests should be presented in the consolidated statement of financial position within net assets/equity, separately from the controlling entity's net assets/equity (see paragraph 54)?

Question 3

Do you agree that in the investor's separate financial statements, investments in controlled entities, jointly controlled entities and associates should be accounted for either:

(a) at cost, or

(b) as financial instruments in accordance with the relevant international or national accounting standard dealing with the recognition and measurement of financial instruments?

Alternatively, do you agree that these investments should be accounted for as investments as specified in the existing IPSAS 6 (see paragraphs 58 and 61 in the proposed IPSAS 6 and paragraph 53 in the existing IPSAS 6)?

Question 4

Do you agree that investments in controlled entities, jointly controlled entities and associates that are accounted for as financial instruments in the consolidated financial statements should be accounted for in the same way in the investor's separate financial statements (see paragraphs 60 and 61)?

Question 5

Do you agree that a list of significant controlled entities should be disclosed in the controlling entity's consolidated financial statements (see paragraph 62)?

SUMMARY OF MAIN CHANGES IPSAS 6 CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS

The main changes proposed are:

Scope

- to clarify in paragraph 3 that the Standard applies to accounting for controlled entities, jointly controlled entities and associates in the separate financial statements of a controlling entity, a venturer or an investor. Therefore, the title of the Standard is amended to *Consolidated and Separate Financial Statements*.

  Previously, IPSAS 6 only applied to accounting for controlled entities. The title for the Standard was *Consolidated Financial Statements and Accounting for Controlled Entities*.

Definitions

- in paragraph 7:
  - to define two new terms: “cost method” and “separate financial statements”.
  - to remove the following unnecessary definitions: “accounting policies”, “accrual basis”, “assets”, “associates”, “cash”, “contributions from owners”, “distributions to owners”, “equity method”, “expenses”, “government business enterprises”, “investor in a joint venture”, “joint control”, “joint venture”, “liabilities”, “net assets/equity”, “reporting date”, “revenue” and “significant influence”.
  - to remove the term “net surplus/deficit”, which no longer exists. This definition has also been eliminated from IPSAS 1, “Presentation of Financial Statements” and IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors”.
- to include in paragraphs 8-11 further illustrations of the term “separate financial statements”. Previously, IPSAS 6 did not contain these illustrations.

Exemptions from Preparing Consolidated Financial Statements

- to clarify and tighten in paragraph 16 the circumstances in which a controlling entity is exempted from preparing consolidated financial statements. A controlling entity need not present consolidated financial statements if and only if:
  - the controlling entity is itself a wholly-owned controlled entity and users of such financial statements are unlikely to exist or their information needs are

met by its controlling entity's consolidated financial statements; or the controlling entity is a partially-owned controlled entity of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the controlling entity not preparing consolidated financial statements;

- o the controlling entity's 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);
- o the controlling entity 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
- o the ultimate or any intermediate controlling entity of the controlling entity produces consolidated financial statements available for public use that comply with International Public Sector Accounting Standards.

Previously, IPSAS 3 specified that a controlling entity that is a wholly owned controlled entity, or is a virtually wholly owned, need not present consolidated financial statements provided users of such financial statements are unlikely to exist or their information needs are met by the controlling entity's consolidated financial statements; or, in the case of one that is virtually wholly owned, the controlling entity obtains the approval of the owners of the minority interest.

Exemptions from Consolidation

- to clarify in paragraph 21 that a controlled entity shall be excluded from consolidation when there is evidence that (a) control is intended to be temporary because the controlled entity is acquired and held exclusively with a view to its disposal within twelve months from acquisition and (b) management is actively seeking a buyer. The proposed IPSAS 6 further specifies that when a controlled entity previously excluded from consolidation is not disposed of within twelve months, it must be consolidated as from the acquisition date unless narrowly specified circumstances apply.

  The words "in the near future" used in previous IPSAS 6 were replaced with the words "within twelve months". In addition, there was no similar requirement to (b) in previous IPSAS 6 for exclusion from consolidation.

- to clarify in paragraph 26 that the requirement to consolidate investments in controlled entities applies to venture capital organization, mutual funds, unit trusts and similar entities. Previously, IPSAS 6 did not contain this clarification.

- to remove the previous exemption from consolidating for an entity which operates under external long-term severe restrictions which prevents the controlling entity from benefiting from its activities (see previous paragraphs 22(b) and 25).

Consolidation Procedures

- to require an entity to consider the existence and effect of potential voting rights currently exercisable or convertible when assessing whether it has the power to govern the financial and operating policies of another entity (see paragraphs 33, 34). Previously, IPSAS 6 did not contain these requirements.
- to clarify in paragraph 49 that an entity shall use uniform accounting policies for reporting like transactions and other events in similar circumstances. Previously, IPSAS 6 provided an exception to this requirement when it was "not practicable to use uniform accounting policies".
- to require in paragraph 54 that minority interests shall be presented in the consolidated statement of financial position within net assets/equity, separately from the controlling entity's net assets/equity. Previously, though IPSAS 6 precluded presentation of minority interests within liabilities, it did not require presentation within net assets/equity.

Separate Financial Statements

- to require in paragraph 58 investments in controlled entities, jointly controlled entities and associates in separate financial statements to be accounted for at cost or as financial instruments. The equity method contained in previous IPSAS 6 has been removed.
- to require in paragraph 60 that controlled entities, jointly controlled entities and associates that are accounted for as financial instruments in the consolidated financial statements shall be accounted for in the same way in the investor's separate financial statements. Previously, IPSAS 6 did not contain this requirement.

Disclosure

- to require additional disclosures in respect of separate financial statements (see paragraphs 63 and 64)

Amendments to Other IPSASs

- to include an authoritative appendix of amendments to other IPSASs that are not part of the IPSASs Improvements project and will be impacted as a result of the proposals in this IPSAS.

Implementation Guidance

- to include an Implementation Guidance, which illustrates how to consider the impact of potential voting rights on an entity's power to govern the financial and operating policies of another entity when implementing IPSAS 6, IPSAS 7, “Investments in Associates” and IPSAS 8, “Interests in Joint Ventures”.

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD 6—CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS

CONTENTS

Paragraph ~~and Accounting for Controlled Entities~~

International Public Sector Accounting Standard 6, Consolidated and Separated Financial Statements" (IPSAS 6) is set out in paragraphs 1-71 and the Appendix. All the paragraphs have equal authority. IPSAS 6 should be read in the context of the Basis for Conclusion (if any), and the "Preface to International Public Sector Accounting Standards". IPSAS 3, "Accounting Policies, Changes in Accounting Estimates and Errors" provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD 6—CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS

~~*The standards, which have been set in bold italic type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the "Preface to International Public Sector Accounting Standards". International Public Sector Accounting Standards are not intended to apply to immaterial items.*~~

Scope

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

~~7~~2. This Standard does not deal with~~:~~

~~(a)~~ methods of accounting for entity combinations and their effects on consolidation, including goodwill arising on a entity combination (guidance on accounting for entity combinations can be found in the relevant i~~I~~nternational or national ~~A~~accounting ~~S~~standard dealing with ~~IAS 22,~~ ~~B~~business ~~C~~combinations);

~~2~~3. **This Standard ~~should~~ shall also be applied in accounting for controlled entities, jointly controlled entities and associates when an entity elects, or is required by local regulations, to present ~~in a controlling entity's~~ separate financial statements.**

~~3.~~ [deleted]

4. **This Standard applies to ~~the preparation and presentation of consolidated financial statements, and accounting for controlled entities, by~~ all public sector entities other than Government Business Enterprises.**

5. The "Preface to International Public Sector Accounting Standards" issued by the International Public Sector Accounting Standards Board (IPSASB) explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB). ~~Government Business Enterprises (~~GBEs~~)~~ are defined in IPSAS 1, "Presentation of Financial Statements". ~~required to comply with International Accounting Standards (IASs) issued by the International Accounting Standards Committee. The Public Sector Committee's Guideline No. 1 *Financial Reporting by Government Business Enterprises* notes that IASs are relevant to all business enterprises, regardless of whether they are in the private or public sector. Accordingly, Guideline No.~~

~~1 recommends that GBEs should present financial statements that conform, in all material respects, to IASs.~~

6. This Standard establishes requirements for the preparation and presentation of consolidated financial statements, and for accounting for controlled entities, jointly controlled entities and associates in the separate financial statements of the controlling entity, the venturer and the investor. 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, jointly controlled entities and associates that are GBEs. In these circumstances, this Standard ~~should~~ shall be applied in consolidating GBEs into the financial statements of the economic entity, and in accounting for investments in GBEs in the controlling entity's, the venturer's and the investor's separate financial statements.

~~7.~~ [deleted]

Definitions

~~8~~7. **The following terms are used in this Standard with the meanings specified:**

~~Accounting policies~~ [deleted]

~~Accrual basis~~[deleted]

~~Assets~~ [deleted]

~~Associate~~[deleted]

~~Cash~~[deleted]

Consolidated financial statements are the financial statements of an economic entity presented as those of a single entity.

~~Contributions from owners~~[deleted]

Control is the power to govern the financial and operating policies of another entity so as to benefit from its activities.

Controlled entity is an entity, including an unincorporated entity such as a partnership, that is under the control of another entity (known as the controlling entity).

Controlling entity is an entity that has one or more controlled entities.

The cost method is a method of accounting for an investment whereby the investment is recognized at cost. The investor recognizes revenue from the investment only to the extent that the investor is entitled to receive distributions from accumulated surpluses of the investee arising

after the date of acquisition. Entitlements due or received in excess of such surpluses are regarded as a recovery of investment and are recognized as a reduction of the cost of the investment.

~~Distributions to owners~~[deleted]

Economic entity means a group of entities comprising a controlling entity and one or more controlled entities.

~~Equity method~~[deleted]

~~Expenses~~[deleted]

~~Government Business Enterprise~~[deleted]

~~Investor in a joint venture~~ [deleted]

~~Joint venture~~[deleted]

~~Liabilities~~[deleted]

Minority interest is that ~~part~~ portion of the ~~net~~ surplus ~~(~~ or deficit~~)~~ and ~~of~~ net assets/equity of a controlled entity attributable to net assets/equity interests ~~which~~ that are not owned, directly or indirectly through controlled entities, by the controlling entity.

~~Net assets/equity~~[deleted]

~~Reporting date~~[deleted]

~~Revenue~~[deleted]

Separate financial statements are those presented by a controlling entity, an investor in an associate or a venturer in a jointly controlled entity, in which the investments are accounted for on the basis of the direct net assets/equity interest rather than on the basis of the reported results and net assets of the investees.

~~Significant influence~~ [deleted]

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

Consolidated Financial Statements and Separate Financial Statements

8. A controlling entity or its controlled entity may be an investor in an associate or a venturer in a jointly controlled entity. In such cases, consolidated financial statements prepared and presented in accordance with this Standard

are also prepared so as to comply with IPSAS 7, "Investments in Associates" and IPSAS 8, "Interests in Joint Ventures".

9. For an entity described in paragraph 8, separate financial statements are those prepared and presented in addition to the financial statements referred to in paragraph 8. Separate financial statements need not be appended to, or accompany, those statements.

10. The financial statements of an entity that does not have a controlled entity, associate or venturer's interest in a jointly controlled entity are not separate financial statements.

11. A controlling entity that is exempted in accordance with paragraph 16 from presenting consolidated financial statements may present separate financial statements as its only financial statements.

Economic Entity

~~9~~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.

~~10~~13. Other terms sometimes used to refer to an economic entity include "administrative entity", "financial entity", "consolidated entity" and "group".

~~11~~14. An economic entity may include entities with both social policy and commercial objectives. For example, a government housing department may be an economic entity which includes entities that provide housing for a nominal charge, as well as entities that provide accommodation on a commercial basis.

~~**Future Economic Benefits or Service Potential**~~

~~12.~~ [deleted]

~~**Government Business Enterprises**~~

~~13.~~ [deleted]

~~**Net Assets/Equity**~~

~~14.~~ [deleted]

Presentation of Consolidated Financial Statements

15. **A controlling entity, other than a controlling entity ~~mentioned~~ described in paragraph 16, ~~should~~ shall present consolidated financial statements in which it consolidates its controlled entities in accordance with this Standard.**

16. **A controlling entity ~~that is a wholly owned controlled entity, or is virtually wholly owned,~~ need not present consolidated financial statements ~~provided~~ if and only if:**

(a) **the controlling entity is:**

- **itself a wholly-owned controlled entity and users of such financial statements are unlikely to exist or their information needs are met by ~~the~~ its controlling entity's consolidated financial statements; or**

- **a ~~, in the case of one that is virtually wholly~~ partially-~~-~~owned controlled entity of~~, the controlling~~ another entity ~~obtains the approval of the~~ and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the controlling entity not presenting consolidated financial statements;~~ of the minority interest. Such a controlling entity should disclose the reasons why consolidated financial statements have not been presented together with the bases on which controlled entities are accounted for in its separate financial statements. The name and the principal address of its controlling entity that publishes consolidated financial statements should also be disclosed.~~**

(b) **the controlling entity's 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);**

(c) **the controlling entity 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**

(d) **the ultimate or any intermediate controlling entity of the controlling entity produces consolidated financial statements available for public use that comply with International Public Sector Accounting Standards.**

~~17.~~ [deleted]

~~18~~17. ~~A controlling entity that is itself wholly owned by another entity may not always present consolidated financial statements since such statements may not be required by its controlling entity and the needs of other users may be best served by the consolidated financial statements of its controlling entity. However, i~~In the public sector many controlling entities that are either wholly owned or ~~virtually wholly~~ partially owned, represent key sectors or activities of a government and the purpose of this Standard is not to exempt such entities from preparing consolidated financial statements. In this situation, the information needs of certain users may not be served by the consolidated financial statements at a whole-of-government level alone. In many jurisdictions, governments have recognized this and have legislated the financial reporting requirements of such entities.

~~19.~~ [deleted]

~~20~~18. In some instances, an economic entity will include a number of intermediate controlling entities. For example, whilst a department of health may be the ultimate controlling entity, there may be intermediate controlling entities at the local or regional health authority level. Accountability and reporting requirements in each jurisdiction may specify which entities are required to (or exempted from the requirement to) prepare consolidated financial statements. Where there is no specific reporting requirement for an intermediate controlling entity to prepare consolidated financial statements for which users are likely to exist, intermediate controlling entities are to prepare and publish consolidated financial statements.

19. A controlling entity that elects in accordance with paragraph 16 not to present consolidated financial statements, and presents only separate financial statements, complies with paragraphs 58-64.

Scope of Consolidated Financial Statements

~~21~~20. **~~A controlling entity which issues c~~Consolidated financial statements ~~should~~ shall ~~consolidate~~ include all controlled entities of the controlling entity, ~~foreign and domestic,~~ ~~other than~~ except those referred to in paragraph ~~22~~21.**

~~22~~21. **A controlled entity ~~should~~ shall be excluded from consolidation when ~~:~~**

~~(a)~~ there is evidence that (a) control is intended to be temporary because the controlled entity is acquired and held exclusively with a view to its ~~subsequent~~ disposal within twelve months from acquisition and (b) management is actively seeking a buyer. ~~in the near future; or~~

~~(b) it operates under severe external long-term restrictions which prevent the controlling entity from benefiting from its activities.~~

~~23~~22. Such controlled entities ~~should~~ shall be classified and accounted for as ~~if they are investments~~ financial instruments. The relevant ~~I~~international or national ~~A~~accounting ~~s~~Standard dealing with the recognition and measurement of financial instruments ~~IAS 39, Financial Instruments: Recognition and Measurement~~ provides guidance on classification and accounting for ~~investments~~ financial instruments.

~~24~~23. An example of temporary control is where a controlled entity is acquired with a firm plan to dispose of it ~~in the short term~~ within twelve months. This may occur where an economic entity is acquired and an entity within it is to be disposed of because its activities are dissimilar to those of the acquirer. Temporary control also occurs where the controlling entity intends to cede control over a controlled entity to another entity — for example a national government may transfer its interest in a controlled entity to a local government. For this exemption to apply, the controlling entity must be demonstrably committed to a formal plan to dispose of, or no longer control, the entity that is subject to temporary control. ~~For the exemption to apply at more than one successive reporting date, the controlling entity must demonstrate an ongoing intent to dispose of, or no longer control, the entity that is subject to temporary control.~~ An entity is demonstrably committed to dispose of, or no longer control, another entity when it has a formal plan to do so and there is no realistic possibility of withdrawal from that plan.

24. When a controlled entity previously excluded from consolidation in accordance with paragraph 21 is not disposed of within twelve months, it shall be consolidated as from the acquisition date (guidance on the acquisition date can be found in the relevant international or national accounting standard dealing with business combinations). Financial statements for the periods since acquisition shall be restated.

25. Exceptionally, an entity may have found a buyer for a controlled entity excluded from consolidation in accordance with paragraph 21, but may not have completed the sale within twelve months of acquisition because of the need for approval by regulators or others. The entity is not required to consolidate such a controlled entity if the sale is in process at the reporting date and there is no reason to believe that it will not be completed shortly after the reporting date.

26. A controlled entity is not excluded from consolidation simply because the investor is a venture capital organization, mutual fund, unit trust or similar entity.

~~38~~27. ~~Sometimes a~~A controlled entity is not excluded from consolidation ~~when~~ because its activities are dissimilar to those of the other entities within the economic entity, for example, the consolidation of GBEs with entities in the budget sector. ~~Exclusion on these grounds is not justified because better~~ Relevant information ~~would be~~ 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, ~~disaggregated~~ the disclosures required by IPSAS 18, "Segment Reporting"

~~can~~ help to explain the significance of different activities within the economic entity.

~~25.~~ [deleted]

Establishing Control of Another Entity for Financial Reporting Purposes

~~26~~28. Whether an entity controls another entity for financial reporting purposes is a matter of judgment based on the definition of control in this Standard and the particular circumstances of each case. That is, consideration needs to be given to the nature of the relationship between the two entities. In particular, the two elements of the definition of control in this Standard need to be considered. These are the power element (the power to govern the financial and operating policies of another entity) and the benefit element (which represents the ability of the controlling entity to benefit from the activities of the other entity).

~~27~~29. For the purposes of establishing control, the controlling entity needs to benefit from the activities of the other entity. For example, an entity may benefit from the activities of another entity in terms of a distribution of its surpluses (such as a dividend) and is exposed to the risk of a potential loss. In other cases, an entity may not obtain any financial benefits from the other entity but may benefit from its ability to direct the other entity to work with it to achieve its objectives. It may also be possible for an entity to derive both financial and non-financial benefits from the activities of another entity. For example, a GBE may provide a controlling entity with a dividend and also enable it to achieve some of its social policy objectives.

Control for Financial Reporting Purposes

~~28~~30. For the purposes of financial reporting, control stems from an entity's power to govern the financial and operating policies of another entity and does not necessarily require an entity to hold a majority shareholding or other equity interest in the other entity. The power to control must be presently exercisable. That is, the entity must already have had this power conferred upon it by legislation or some formal agreement. The power to control is not presently exercisable if it requires changing legislation or renegotiating agreements in order to be effective. This should be distinguished from the fact that the existence of the power to control another entity is not dependent upon the probability or likelihood of that power being exercised.

~~29~~31. Similarly, the existence of control does not require an entity to have responsibility for the management of (or involvement in) the day-to-day operations of the other entity. In many cases, an entity may only exercise its power to control another entity where there is a breach or revocation of an agreement between the controlled entity and its controlling entity.

~~30~~32. For example, a government department may have an ownership interest in a rail authority, which operates as a GBE. The rail authority is allowed to operate autonomously and does not rely on the government for funding but has raised capital through significant borrowings that are guaranteed by the government. The rail authority has not returned a dividend to government for several years. The government has the power to appoint and remove a majority of the members of the governing body of the rail authority. The government has never exercised the power to remove members of the governing body and would be reluctant to do so because of sensitivity in the electorate regarding the previous government's involvement in the operation of the rail network. In this case, the power to control is presently exercisable but under the existing relationship between the controlled entity and controlling entity, an event has not occurred to warrant the controlling entity exercising its powers over the controlled entity. Accordingly, control exists because the power to control is sufficient even though the controlling entity may choose not to exercise that power.

33. An entity may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or other similar instruments that have the potential, if exercised or converted, to give the entity voting power or reduce another party's voting power over the financial and operating policies of another entity (potential voting rights). The existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by another entity, are considered when assessing whether an entity has the power to govern the financial and operating policies of another entity. Potential voting rights are not currently exercisable or convertible when, for example, they cannot be exercised or converted until a future date or until the occurrence of a future event.

34. In assessing whether potential voting rights contribute to control, the entity examines all facts and circumstances (including the terms of exercise of the potential voting rights and any other contractual arrangements whether considered individually or in combination) that affect potential voting rights, except the intention of management and the financial ability to exercise or convert.

~~31~~35. The existence of separate legislative powers does not, of itself, preclude an entity from being controlled by another entity. For example, the Office of the Government Statistician usually has statutory powers to operate independently of the government. That is, the Office of the Government Statistician may have the power to obtain information and report on its findings without recourse to government or any other body. The existence of control does not require an entity to have responsibility over the day-to-day operations of another entity or the manner in which professional functions are performed by the entity.

~~32~~36. The power of one entity to govern decision-making in relation to the financial and operating policies of another entity is insufficient, in itself, to ensure the existence of control as defined in this Standard. The controlling entity needs to be able to govern decision-making so as to be able to benefit from its activities, for example by enabling the other entity to operate with it as part of an economic entity in pursuing its objectives. This will have the effect of excluding from the definitions of a "controlling entity" and "controlled entity" relationships which do not extend beyond, for instance, that of a liquidator and the entity being liquidated, and would normally exclude a lender and borrower relationship. Similarly, a trustee whose relationship with a trust does not extend beyond the normal responsibilities of a trustee would not be considered to control the trust for the purposes of this Standard.

Regulatory and Purchase Power

~~33~~37. Governments and their agencies have the power to regulate the behavior of many entities by use of their sovereign or legislative powers. Regulatory and purchase powers do not constitute control for the purposes of financial reporting. To ensure that the financial statements of public sector entities include only those resources that they control and can benefit from, the meaning of control for the purposes of this Standard does not extend to:

(a) the power of the legislature to establish the regulatory framework within which entities operate and to impose conditions or sanctions on their operations. Such power does not constitute control by a public sector entity of the assets deployed by these entities. For example, a pollution control authority may have the power to close down the operations of entities that are not complying with environmental regulations. However, this power does not constitute control because the pollution control authority only has the power to regulate; or

(b) entities that are economically dependent on a public sector entity. That is, where an entity retains discretion as to whether it will take funding from, or do business with, a public sector entity, that entity has the ultimate power to govern its own financial or operating policies, and accordingly is not controlled by the public sector entity. For example, a government department may be able to influence the financial and operating policies of an entity which is dependent on it for funding (such as a charity) or a profit-orientated entity that is economically dependent on business from it. Accordingly, the government department has some power as a purchaser but not to govern the entity's financial and operating policies.

Determining Whether Control Exists for Financial Reporting Purposes

~~34~~38. Public sector entities may create other entities to achieve some of their objectives. In some cases it may be clear that an entity is controlled, and hence should be consolidated. In other cases it may not be clear. Paragraphs ~~35~~39 and ~~36~~40 provide guidance to help determine whether or not control exists for financial reporting purposes.

~~35~~39. In examining the relationship between two entities, control is presumed to exist when at least one of the following power conditions and one of the following benefit conditions exists, unless there is clear evidence of control being held by another entity.

Power conditions

(a) The entity has, directly or indirectly through controlled entities, ownership of a majority voting interest in the other entity.

(b) The entity has the power, either granted by or exercised within existing legislation, to appoint or remove a majority of the members of the board of directors or equivalent governing body and control of the other entity is by that board or by that body.

(c) The entity has the power to cast, or regulate the casting of, a majority of the votes that are likely to be cast at a general meeting of the other entity.

(d) The entity has the power to cast the majority of votes at meetings of the board of directors or equivalent governing body and control of the other entity is by that board or by that body.

Benefit conditions

(a) The entity has the power to dissolve the other entity and obtain a significant level of the residual economic benefits or bear significant obligations. For example the benefit condition may be met if an entity had responsibility for the residual liabilities of another entity.

(b) The entity has the power to extract distributions of assets from the other entity, and/or may be liable for certain obligations of the other entity.

~~36~~40. When one or more of the circumstances listed in paragraph ~~35~~39 does not exist, the following factors are likely, either individually or collectively, to be indicative of the existence of control.

Power indicators

(a) The entity has the ability to veto operating and capital budgets of the other entity.

(b) The entity has the ability to veto, overrule, or modify governing body decisions of the other entity.

(c) The entity has the ability to approve the hiring, reassignment and removal of key personnel of the other entity.

(d) The mandate of the other entity is established and limited by~~,~~ legislation.

(e) The entity holds a "golden share"[1] (or equivalent) in the other entity that confers rights to govern the financial and operating policies of that other entity.

Benefit indicators

(a) The entity holds direct or indirect title to the net assets/equity of the other entity with an ongoing right to access these.

(b) The entity has a right to a significant level of the net assets/equity of the other entity in the event of a liquidation or in a distribution other than a liquidation.

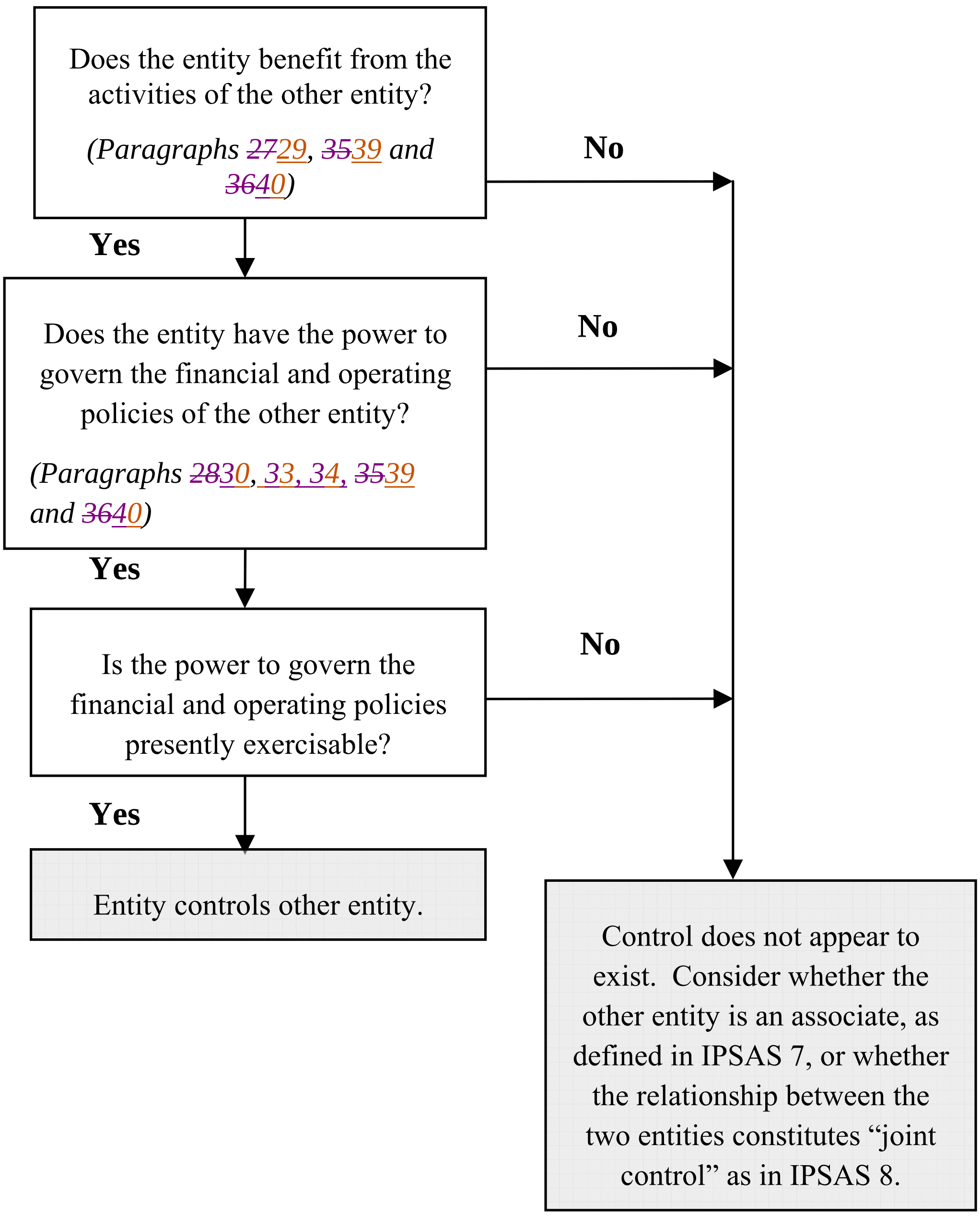
(c) The entity is able to direct the other entity to co-operate with it in achieving its objectives.

(d) The entity is exposed to the residual liabilities of the other entity.

~~37~~41. The following diagram indicates the basic steps involved in establishing control of another entity. It should be read in conjunction with paragraphs ~~26~~28 to ~~36~~40.

[1] "Golden share" refers to a class of share that entitles the holder to specified powers or rights generally exceeding those normally associated with the holder's ownership interest or representation on the governing body.

Establishing Control of another Entity for Financial Reporting Purposes



42. A controlling entity loses control when it loses the power to govern the financial and operating policies of a controlled entity so as to benefit from its activities. The loss of control can occur with or without a change in absolute or relative ownership levels. It could occur, for example, when a controlled entity becomes subject to the control of another government, a court, administrator or regulator. It could also occur as a result of a contractual agreement or, for example, a foreign government may sequester the operating assets of a foreign controlled entity so that the controlling entity loses the power to govern the operating policies of the controlled entity. In this case, control is unlikely to exist.

Consolidation Procedures

~~39~~43. In preparing consolidated financial statements, an entity combines the financial statements of the controlling entity and its controlled entities ~~are combined on a~~ line-by-line ~~basis~~ by adding together like items of assets, liabilities, net assets/equity, revenue and expenses. In order that the consolidated financial statements present financial information about the economic entity as that of a single entity, the following steps are then taken:

(a) 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 are eliminated (~~IAS 22~~ the relevant international or national accounting standard dealing with business combinations provides guidance on the treatment of any resultant goodwill);

(b) minority interests in the ~~net~~ surplus or deficit of consolidated controlled entities for the reporting period are identified ~~and adjusted against the net surplus or deficit of the economic entity in order to arrive at the net surplus or deficit attributable to the owners of the controlling entity~~; and

(c) minority interests in the net assets/equity of consolidated controlled entities are identified ~~and presented in the consolidated statement of financial position~~ separately from ~~liabilities and~~ the controlling entity's net assets/equity in them. Minority interests in the net assets/equity consist of:

  (i) the amount of those minority interests at the date of the original combination (~~IAS 22~~the relevant international or national accounting standard dealing with business combinations provides guidance on calculating this amount); and

  (ii) the minority's share of ~~movements~~ changes in net assets/equity since the date of combination.

44. When potential voting rights exist, the proportions of surplus or deficit and changes in net assets/equity allocated to the controlling entity and minority interests are determined on the basis of present ownership interests and do not reflect the possible exercise or conversion of potential voting rights.

~~40.~~ [deleted]

~~41~~45. **Balances,~~ and~~ transactions, revenues and expenses between entities within the economic entity~~ and resulting unrealized gains should~~ shall be eliminated in full.~~ Unrealized losses resulting from transactions within the economic entity should also be eliminated unless cost cannot be recovered.~~**

~~42~~46. Balances and transactions between entities within the economic entity, including revenues from sales~~,~~ and transfers,~~ and~~ revenues recognized consequent to an appropriation or other budgetary authority, expenses and dividends, are eliminated in full. ~~Unrealized s~~Surpluses and deficits resulting from transactions within the economic entity that are~~ included~~ recognized in ~~the carrying amount of~~ assets, such as inventory and fixed assets, are eliminated in full. ~~Unrealized d~~Deficits within the economic entity may indicate an impairment that requires recognition in the consolidated financial statements.~~ resulting from transactions within the economic entity that are deducted in arriving at the carrying amount of assets are also eliminated unless cost cannot be recovered~~. Guidance on accounting for~~ timing~~ temporary differences that arise from the elimination of~~ unrealized~~ surpluses and deficits resulting from transactions within the economic entity, can be found in ~~IAS 12~~ the relevant international or national accounting standard dealing with ~~I~~income ~~T~~taxes.

~~43~~47. **~~When t~~The financial statements of the controlling entity and its controlled entities used in the~~ consolidation~~ preparation of the consolidated financial statements shall be prepared as of the same reporting date. When the reporting dates of the controlling entity and a controlled entity are~~ drawn up to~~ different~~ reporting dates~~, the controlled entity prepares, for consolidation purposes, additional financial statements as of the same date as the financial statements of the controlling entity unless it is impracticable to do so.~~adjustments should be made for the effects of significant transactions or other events that occur between those dates and the date of the controlling entity's financial statements. In any case the difference between reporting dates should be no more than three months.~~**

~~44~~48. **When in accordance with paragraph 47, ~~T~~the financial statements of~~ the controlling entity and its~~ a controlled entit~~ies~~y used in the preparation of**

~~the~~ consolidated financial statements are ~~usually drawn up to the same date. When~~ prepared as of ~~the~~ a reporting date~~s are~~ different from that of the controlling entity, adjustments shall be made for the effects of significant transactions or events that occur between that date and the date of the controlling entity's financial statements. ~~the controlled entity often prepares, for consolidation purposes, statements as at the same date as the economic entity. When it is impracticable to do this, financial statements drawn up to different~~ In any case, the difference between the reporting date~~s~~ of the controlled entity and that of the controlling entity ~~may~~ shall be ~~used provided the difference is~~ no ~~greater~~ more than three months. ~~The consistency principle dictates that t~~The length of the reporting periods and any difference in the reporting dates ~~should~~ shall be the same from period to period.

~~45~~49. **Consolidated financial statements ~~should~~ shall be prepared using uniform accounting policies for like transactions and other events in similar circumstances. ~~If it is not practicable to use uniform accounting policies (other than the bases of accounting) in preparing the consolidated financial statements, that fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.~~**

~~46~~50. 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 its financial statements ~~when they are used~~ in preparing the consolidated financial statements.

~~47~~51. The ~~net surplus or deficit~~ revenue and expenses of a controlled entity ~~is~~ are included in the consolidated financial statements ~~as~~ from the acquisition date ~~on which control becomes effective~~ (the relevant international or national accounting standard dealing with business combinations provides guidance on the meaning of the acquisition date). The ~~surplus or deficit from operating activities~~ revenue and expenses of a controlled entity ~~disposed of is~~ are included in the consolidated financial statements ~~of financial performance~~ until the date ~~of disposal, which is the date~~ on which the controlling entity ceases to ~~have~~ control ~~of~~ the controlled entity. The difference between the proceeds from the disposal of the controlled entity and its ~~the~~ carrying amount ~~of its assets less liabilities~~ as of the date of disposal, including the cumulative amount of any exchange differences that relate to the controlled entity recognized in net assets/equity in accordance with IPSAS 4, "The Effects of Changes in Foreign Exchange Rates", is recognized in the consolidated statement of financial performance as the ~~net surplus~~ gain or ~~deficit~~ loss on the disposal of the controlled entity. ~~In order to ensure the comparability of the financial statements from one accounting period to the next, supplementary information is often provided about the effect of the~~

~~acquisition and disposal of controlled entities on the financial position at the reporting date and the results for the reporting period and on the corresponding amounts for the preceding period.~~

~~48~~52. From the date an entity ceases to ~~fall within the definition of~~ be a controlled entity~~, and~~ provided that it does not become an associate as defined in IPSAS 7~~,~~ or a jointly controlled entity as defined in IPSAS 8, it ~~should~~ shall be accounted for as ~~an investment~~ a financial instrument. ~~IAS 39~~ The relevant international or national accounting standard dealing with the recognition and measurement of financial instruments provides guidance on accounting for ~~investments~~ financial instruments.

~~49~~53. The carrying amount of the investment at the date that ~~it~~ the entity ceases to be a controlled entity ~~is~~ shall be regarded as the cost ~~thereafter~~ on initial measurement of a financial instrument.

~~50~~54. **Minority interests ~~should~~ shall be presented in the consolidated statement of financial position within net assets/equity, separately from ~~liabilities and~~ the controlling entity's net assets/equity. Minority interests in the ~~net~~ surplus or deficit of the economic entity ~~should~~ shall also be separately ~~presented~~ disclosed.**

55. The surplus or deficit is attributed to the controlling entity and minority interests. Because both are net assets/equity, the amount attributed to minority interests is not revenue or expense.

~~51~~56. ~~The l~~Losses applicable to the minority in a consolidated controlled entity may exceed the minority interest in ~~the net assets/equity of~~ the controlled entity's net assets/equity. The excess, and any further losses applicable to the minority, are ~~charged~~ allocated against the majority interest except to the extent that the minority has a binding obligation ~~to,~~ and is able to~~,~~ make ~~good~~ an additional investment to cover the losses. If the controlled entity subsequently reports surpluses, ~~the majority interest is allocated all~~ such surpluses are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered.

~~52~~57. If a controlled entity has outstanding cumulative ~~preferred~~ preference shares ~~which~~ that are held ~~outside the economic entity~~ by minority interests and classified as net assets/equity, the controlling entity computes its share of surpluses or ~~and losses~~deficits after adjusting for the ~~controlled entity's preferred~~ dividends on such shares, whether or not dividends have been declared.

Accounting for Controlled Entities, Jointly Controlled Entities and Associates in ~~a Controlling Entity's~~ Separate Financial Statements

~~53~~58. **~~In a controlling entity's~~When separate financial statements are prepared, investments in controlled entities, jointly controlled entities and associates ~~that are included in the consolidated financial statements should~~ shall be accounted for either:**

(a) **at cost, ~~accounted for using the equity method as described in IPSAS 7~~ or**

(b) **~~accounted for~~ as ~~an investment~~ financial instruments.**

The same accounting shall be applied for each category of investments.

59. This Standard does not mandate which entities produce separate financial statements available for public use. Paragraphs 58 and 60-64 apply when an entity prepares separate financial statements that comply with International Public Sector Accounting Standards. The entity also produces consolidated financial statements available for public use as required by paragraph 15, unless the exemption provided in paragraph 16 is applicable.

~~54~~60. **Controlled entities, jointly controlled entities and associates that are ~~excluded from consolidation should be~~ accounted for as ~~investments~~ financial instruments in the ~~controlling entity's separate~~ consolidated financial statements shall be accounted for in the same way in the investor's separate financial statements.**

~~55~~61. Guidance on accounting for ~~investments~~ financial instruments can be found in the relevant international ~~and/~~or national accounting standard~~s~~ dealing with the recognition and measurement of financial instruments.

~~56.~~ [deleted]

Disclosure

~~57~~62. **~~In addition to those disclosures required by paragraph 16, t~~The following disclosures ~~should~~ shall be made in consolidated financial statements:**

(a) **~~in consolidated financial statements,~~ a list of significant controlled entities ~~including the name, the jurisdiction in which it operates (when it is different from that of the controlling entity), proportion of ownership interest and, where that interest is in the form of shares, the proportion of voting power held (only where this is different from the proportionate ownership interest)~~;**

(b) **the fact that a controlled entity is not consolidated in accordance with paragraph 21**

(c) **summarized financial information of controlled entities, either individually or in groups, that are not consolidated, including the amounts of total assets, total liabilities, revenues and surplus or deficit;**

(~~b~~d)**~~in consolidated financial statements, where applicable:~~**

~~(i) the reasons for not consolidating a controlled entity;~~

~~(ii)~~ the name of any controlled entity in which the controlling entity holds an ownership interest and/or voting rights of 50% or less, together with an explanation of how control exists;

(~~iii~~e) **~~the name of any entity in which~~the reasons why ~~an~~ the ownership interest of more than 50% of the voting or potential voting power of an investee ~~is held but~~ ~~which is~~ does not constitute ~~a~~ control~~led entity, together with an explanation of why control does not exist~~; ~~and~~**

~~(iv) the effect of the acquisition and disposal of controlled entities on the financial position at the reporting date, the results for the reporting period and on the corresponding amounts for the preceding period; and~~

~~(c) in the controlling entity's separate financial statements, a description of the method used to account for controlled entities.~~

(f) **the reporting date of the financial statements of a controlled entity when such financial statements are used to prepare consolidated financial statements and are as of a reporting date or for a period that is different from that of the controlling entity, and the reason for using a different reporting date or period; and**

(g) **the nature and extent of any significant restrictions (eg resulting from borrowing arrangements or regulatory requirements) on the ability of controlled entities to transfer funds to the controlling entity in the form of cash dividends or to repay loans or advances.**

63. **When separate financial statements are prepared for a controlling entity that, in accordance with paragraph 16, elects not to prepare consolidated financial statements, those separate financial statements shall disclose:**

(a) **the fact that the financial statements are separate financial statements; that the exemption from consolidation has been used; the name of the entity whose consolidated financial statements that comply with International Public Sector Accounting Standards have been produced for public use and the jurisdiction in which**

the entity operates (when it is different from that of the controlling entity); and the address where those consolidated financial statements are obtainable;

(b) **a list of significant controlled entities, jointly controlled entities and associates, including the name, the jurisdiction in which the entity operates (when it is different from that of the controlling entity), proportion of ownership interest and, where that interest is in the form of shares, the proportion of voting power held (only where this is different from the proportionate ownership interest); and**

(c) **a description of the method used to account for the entities listed under (b).**

64. **When a controlling entity (other than a controlling entity covered by paragraph 63), venturer with an interest in a jointly controlled entity or an investor in an associate prepares separate financial statements, those separate financial statements shall disclose:**

(a) **the fact that the statements are separate financial statements and the reasons why those statements are prepared if not required by law, legislation or other authority;**

(b) **a list of significant controlled entities, jointly controlled entities and associates, including the name, the jurisdiction in which the entity operates (when it is different from that of the controlling entity), proportion of ownership interest and, where that interest is in the form of shares, the proportion of voting power held (only where this is different from the proportionate ownership interest); and**

(c) **a description of the method used to account for the entities listed under (b);**

and shall identify the financial statements prepared in accordance with paragraph 15 of this Standard, IPSAS 7 and IPSAS 8 to which they relate.

Transitional Provisions

~~58~~65. **Entities are not required to comply with the requirement in paragraph ~~41~~45 concerning the elimination of balances and transactions between entities within the economic entity for reporting periods beginning on a date within three years following the date of first adoption of~~ this Standard~~ accrual accounting in accordance with International Public Sector Accounting Standards.**

~~59~~66. Controlling entities that adopt ~~this Standard~~ accrual accounting for the first time in accordance with International Public Sector Accounting Standards may have many controlled entities with significant number of transactions between these entities. Accordingly, it may be difficult to identify some transactions and balances that need to be eliminated for the purpose of preparing the consolidated financial statements of the economic entity. For this reason, paragraph ~~58~~65 provides relief from the requirement to eliminate balances and transactions between entities within the economic entity in full.

~~60~~67. **Where entities apply the transitional provision in paragraph ~~58~~65, they ~~should~~ shall disclose the fact that not all balances and transactions occurring between entities within the economic entity have been eliminated.**

68. Transitional provisions in IPSAS 6 (2000) provide entities with a period of up to three years to fully eliminate balances and transactions between entities within the economic entity from the date of its first application. Entities that have previously applied IPSAS 6 (2000) may continue to take advantage of this three-year transitional period from the date of first application of IPSAS 6 (2000).

Effective Date

~~61~~69. **An entity shall apply ~~T~~this International Public Sector Accounting Standard ~~becomes effective~~ for annual financial statements covering periods beginning on or after ~~1 July 2001~~ MM DD, YYYY. Earlier application is encouraged. If an entity applies this Standard for a period beginning before MM DD, YYYY, it shall disclose that fact.**

~~62~~70. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, 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 (2000)

71. This Standard supersedes IPSAS 6, "Consolidated Financial Statements and Accounting for Controlled Entities" issued in 2000.

Appendix

Amendments to Other IPSASs

The amendments in this appendix shall be applied for annual financial statements covering periods beginning on or after MM DD, YYYY. If an entity applies this Standard for an earlier period, these amendments shall be applied for that earlier period.

A1. In International Public Sector Accounting Standards applicable at MM YYYY, references to the current version of IPSAS 6, “Consolidated Financial Statements and Accounting for Controlled Entities” are amended to IPSAS 6, “Consolidated and Separate Financial Statements”.

A2. The following is added to paragraph 4 (f) of IPSAS 15, “Financial Instruments: Disclosure and Presentation”:

However, entities shall apply this Standard to an interest in a controlling entity, associate or joint venture that according to IPSAS 6, IPSAS 7 or IPSAS 8 is accounted for as a financial instrument. In these cases, entities shall apply the disclosure requirements in IPSAS 6, IPSAS 7 and IPSAS 8 in addition to those in this Standard.

Implementation Guidance - Consideration of Potential Voting Rights

Guidance on implementing IPSAS 6, "Consolidated and Separate Financial Statements", IPSAS 7, "Investments in Associates" and IPSAS 8, "Interests in Joint Ventures".

This guidance accompanies IPSAS 6, IPSAS 7 and IPSAS 8, but is not part of them.

Introduction

IG1 Most public sector entities do not issue financial instruments with potential voting rights. However, they may be issued by GBEs. Therefore, a government or other public sector entity may hold potential voting rights of GBEs.

IG2. Paragraphs 33, 34 and 44 of IPSAS 6, "Consolidated and Separate Financial Statements" and paragraphs 14 and 15 of IPSAS 7, "Investments in Associates" require an entity to consider the existence and effect of all potential voting rights that are currently exercisable or convertible. They also require all facts and circumstances that affect potential voting rights to be examined, except the intention of management and the financial ability to exercise or convert potential voting rights. Because the definition of joint control in paragraph 6 of IPSAS 8, "Interests in Joint Ventures" depends upon the definition of control, and because that Standard is linked to IPSAS 7 for application of the equity method, this guidance is also relevant to IPSAS 8.

Guidance

IG3. Paragraph 7 of IPSAS 6 defines control as the power to govern the financial and operating policies of an entity so as to benefit from its activities. Paragraph 7 of IPSAS 7 defines significant influence as the power to participate in the financial and operating policy decisions of the investee but not to control those policies. Paragraph 6 of IPSAS 8 defines joint control as the agreed sharing of control over an activity by a binding agreement. In these contexts, power refers to the ability to do or effect something. Consequently, an entity has control, joint control or significant influence when it currently has the ability to exercise that power, regardless of whether control, joint control or significant influence is actively demonstrated or is passive in nature. Potential voting rights held by an entity that are currently exercisable or convertible provide this ability. The ability to exercise power does not exist when potential voting rights lack economic substance (eg the exercise price is set in a manner that precludes exercise or conversion in any feasible scenario). Consequently, potential voting rights are considered when, in substance, they provide the ability to exercise power.

IG4. Control and significant influence also arise in the circumstances described in paragraphs 39 and 40 of IPSAS 6 and paragraphs 12 and 13 of IPSAS 7 respectively, which include consideration of the relative ownership of voting rights. IPSAS 8 depends on IPSAS 6 and IPSAS 7 and references to IPSAS 6 and IPSAS 7 from this point onwards should be read as being relevant to IPSAS 8. Nevertheless it should be borne in mind that joint control involves sharing of control by a binding agreement and this aspect is likely to be the critical determinant. Potential voting rights such as share call options and convertible debt are capable of changing an entity's voting power over another entity—if the potential voting rights are exercised or converted, then the relative ownership of the ordinary shares carrying voting rights changes. Consequently, the existence of control (the definition of which permits only one entity to have control of another entity) and significant influence are determined only after assessing all the factors described in paragraphs 39 and 40 of IPSAS 6 and paragraphs 12 and 13 of IPSAS 7 respectively, and considering the existence and effect of potential voting rights. In addition, the entity examines all facts and circumstances that affect potential voting rights except the intention of management and the financial ability to exercise or convert. The intention of management does not affect the existence of power and the financial ability of an entity to exercise or convert is difficult to assess.

IG5. An entity may initially conclude that it controls or significantly influences another entity after considering the potential voting rights that it can currently exercise or convert. However, the entity may not control or significantly influence the other entity wh en potential voting rights held by other parties are also currently exercisable or convertible. Consequently, an entity considers all potential voting rights held by it and by other parties that are currently exercisable or convertible when determining whether it controls or significantly influences another entity. For example, all share call options are considered, whether held by the entity or another party. Furthermore, the definition of control in paragraph 7 of IPSAS 6 permits only one entity to have control of another entity. Therefore, when two or more entities each hold significant voting rights, both actual and potential, the factors in paragraphs 39 and 40 of IPSAS 6 are reassessed to determine which entity has control.

IG6. The proportion allocated to the controlling entity and minority interests in preparing consolidated financial statements in accordance with IPSAS 6, and the proportion allocated to an investor that accounts for its investment using the equity method in accordance with IPSAS 7, are determined solely on the basis of present ownership interests. The proportion allocated is determined taking into account the eventual exercise of potential voting rights and other derivatives that, in substance, give access at present to the economic benefits associated with an ownership interest.

IG7. In some circumstances an entity has, in substance, a present ownership as a result of a transaction that gives it access to the economic benefits or service potential associated with an ownership interest. In such circumstances, the proportion allocated is determined taking into account the eventual exercise of those potential voting rights and other derivatives that give the entity access to the economic benefits at present.

IG8. The relevant international or national accounting standard dealing with the recognition and measurement of financial instruments provides guidance on accounting for financial instruments. However, it does not apply to interests in controlled entities, associates and jointly controlled entities that are consolidated, accounted for using the equity method or proportionately consolidated in accordance with IPSAS 6, IPSAS 7 and IPSAS 8 respectively. When instruments containing potential voting rights in substance currently give access to the economic benefits or service potential associated with an ownership interest, and the investment is accounted for in one of the above ways, the instruments are not subject to the requirements of the relevant international or national accounting standard dealing with the recognition and measurement of financial instruments. In all other cases, guidance on accounting for instruments containing potential voting rights can be found in the relevant international or national accounting standard dealing with the recognition and measurement of financial instruments.

Illustrative Examples

IG9. The ten examples below each illustrate one aspect of a potential voting right. In applying IPSAS 6, IPSAS 7 or IPSAS 8, an entity considers all aspects. The existence of control, significant influence and joint control can be determined only after assessing the other factors described in IPSAS 6, IPSAS 7 and IPSAS 8. For the purpose of these examples, however, those other factors are presumed not to affect the determination, even though they may affect it when assessed.

Example 1A: Options are out of the money

Entities A and B own 80 per cent and 20 per cent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity C. Entity A sells one-half of its interest to Entity D and buys call options from Entity D that are exercisable at any time at a premium to the market price when issued, and if exercised would give Entity A its original 80 per cent ownership interest and voting rights.

Though the options are out of the money, they are currently exercisable and give Entity A the power to continue to set the operating and financial policies of Entity C, because Entity A could exercise its options now. The existence of the potential voting rights, as well as the other factors described in paragraphs 39 and 40 of IPSAS 6, are considered and it is determined that Entity A controls Entity C.

Example 1B: Right to Purchase at Premium to Fair Value

The municipalities of Dunelm and Eboracum own 80 per cent and 20 per cent respectively of Dunelm-Eboracum General Hospital, a public sector entity established by charter. The hospital is managed by a board of ten trustees, appointed by the municipalities in proportion to their ownership interest of the hospital. The charter permits either municipality to sell part or its entire ownership interest in the hospital to another municipality within the region. Dunelm sells one-half of its interest to the municipality of Formio, however the sale contract gives Dunelm the right to repurchase Formio's interest in the hospital at an amount equal to 115 per cent of the fair value of the ownership interest determined by an independent valuer. This right is exercisable at any time and, if exercised would give Dunelm its original 80 per cent ownership interest and the right to appoint trustees accordingly.

Although the right to reacquire the ownership interest sold to Formio would involve paying a premium over the fair value, the right is currently exercisable and gives Dunelm the power to continue to set the operating and financial policies of the Dunelm-Eboracum General Hospital, because Dunelm could exercise its right to reacquire Formio's interest now. The existence of the potential right to appoint trustees, as well as the other factors described in paragraphs 39 and 40 of IPSAS 6, are considered and it is determined that the municipality of Dunelm controls the Dunelm-Eboracum General Hospital.

Example 2A: Possibility of exercise or conversion

Entities A, B and C own 40 per cent, 30 per cent and 30 per cent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity D. Entity A also owns call options that are exercisable at any time at the fair value of the underlying shares and if exercised would give it an additional 20 per cent of the voting rights in Entity D and reduce Entity B's and Entity C's interests to 20 per cent each. If the options are exercised, Entity A will have control over more than one-half of the voting power. The existence of the potential voting rights, as well as the other factors described in paragraphs 39 and 40 of IPSAS 6 and paragraphs 20 and 21 of IPSAS 7, are considered and it is determined that Entity A controls Entity D.

Example 2B: Possibility of exercise of rights

The federal government of Arandis, in agreement with the state governments of Brixia and Mutina, establishes the University of Pola-Iluro. The University of Pola-Iluro is near the cities of Pola, Brixia and Iluro, Mutina, which are located next to each other on the border between the two states. The federal legislation that establishes the University of Pola-Iluro provides that the federal minister of education has the right to appoint four of the ten governors that manage the university. The state ministers of education of Brixia and Mutina are given the right to appoint three governors each. The legislation also provides that the federal government has ownership of 40 per cent of the university's net assets, with the state governments having 30 per cent each. The federal legislation gives the federal minister of education the right to acquire an additional 20 percent of the ownership in the university's net assets, with the right to appoint an additional two governors. This right is exercisable at any time, at the discretion of the federal minister. It requires the federal government to pay each state government the fair value of the net assets of the university acquired. If the federal government exercises its right, it would own 60 per cent of the net assets of the university, and have the right to appoint six of the ten governors. This would reduce the state governments' ownership to 20 per cent each, with the right to appoint only two governors each.

The existence of the potential right to appoint the majority of the university's governors, as well as the other factors described in paragraphs 39 and 40 of IPSAS 6 and paragraphs 20 and 21 of IPSAS 7, are considered and it is determined that the federal government of Arandis controls the University of Pola-Iluro.

Example 3A: Other rights that have the potential to increase an entity's voting power or reduce another entity's voting power

Entities A, B and C own 25 per cent, 35 per cent and 40 per cent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity D. Entities B and C also have share warrants that are exercisable at any time at a fixed price and provide potential voting rights. Entity A has a call option to purchase these share warrants at any time for a nominal amount. If the call option is exercised, Entity A would have the potential to increase its ownership interest, and thereby its voting rights, in Entity D to 51 per cent (and dilute Entity B's interest to 23 per cent and Entity C's interest to 26 per cent).

Although the share warrants are not owned by Entity A, they are considered in assessing control because they are currently exercisable by Entities B and C. Normally, if an action (eg purchase or exercise of another right) is required before an entity has ownership of a potential voting right, the potential voting right is not regarded as held by the entity. However, the share warrants are, in substance, held by Entity A, because the terms of the call option are designed to ensure Entity A's position. The combination of the call option and share warrants gives Entity A the power to set the operating and financial policies of Entity D, because Entity A could currently exercise the option and share warrants. The other factors described in paragraphs 39 and 40 of IPSAS 6 and paragraphs 20 and 21 of IPSAS 7 are also considered, and it is determined that Entity A, not Entity B or C, controls Entity D.

Example 3B: Other rights that have the potential to increase an entity's voting power or reduce another entity's voting power

The cities of Deva, Oxonia and Isca own 25 per cent, 35 per cent and 40 per cent respectively of the Deva-Oxonia-Isca Electricity Generating Authority, a public sector entity established by charter. The charter gives the cities voting rights in the management of the Authority and the right to receive the electricity generated by the Authority. The voting rights and electricity access are in proportion to their ownership in the Authority. The charter gives Oxonia and Isca rights to increase their ownership (and therefore voting rights) in the Authority each by 10 per cent at any time at a commercial price agreed by the three cities. The charter also gives Deva the right to acquire 15 per cent interest of the Authority from Oxonia and 20 per cent from Isca at any time for a nominal consideration. If Deva exercised the right, Deva would increase its ownership interest, and thereby its voting rights, in Deva-Oxonia-Isca Electric Generating Authority to 60 per cent. This would dilute Oxonia's ownership to 20 per cent and Isca's to 20 per cent.

Although the charter gives Oxonia and Isca the right to increase their proportion of ownership, the overarching right of Deva to acquire a majority interest in the Authority for a nominal consideration set out in the charter is, in substance, designed to ensure Deva's position. The right held by Deva gives Deva the capacity to set the operating and financial policies of the Deva-Oxonia-Isca Electricity Generating Authority, because Deva could exercise the right to increase its ownership and therefore voting rights at any time. The other factors described in paragraphs 39 and 40 of IPSAS 6 and paragraphs 20 and 21 of IPSAS 7 are also considered, and it is determined that Deva, not Oxonia or Isca, controls the Deva-Oxonia-Isca Electricity Generating Authority.

Example 4A: Management intention

Entities A, B and C each own 33⅓ per cent of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity D. Entities A, B and C each have the right to appoint two directors to the board of Entity D. Entity A also owns call options that are exercisable at a fixed price at any time and if exercised would give it all the voting rights in Entity D. The management of Entity A does not intend to exercise the call options, even if Entities B and C do not vote in the same manner as Entity A. The existence of the potential voting rights, as well as the other factors described in paragraphs 39 and 40 of IPSAS 6 and paragraphs 20 and 21 of IPSAS 7, are considered and it is determined that Entity A controls Entity D. The intention of Entity A's management does not influence the assessment.

Example 4B: Management Intention

The cities of Tolosa, Lutetia and Massilia each own 33 1/3 per cent of TLM Water Commission, a public sector entity established by charter to reticulate drinking water to the cities of Tolosa, Lutetia and Massilia and a number of outlying towns and villages. The charter gives each city an equal vote in the governance of the Commission, and the right to appoint two Commissioners each. The Commissioners manage the Commission on behalf of the cities. The charter also gives the city of Tolosa the right to acquire the ownership of Lutetia and Massilia at a fixed price, exercisable at any time by the Mayor of Tolosa. If exercised Tolosa would have sole governance of the Commission with the right to appoint all the Commissioners. The Mayor of Tolosa does not intend to exercise the right to acquire full ownership of Commission, even if the Commissioners appointed by Lutetia and Massilia vote against those appointed by Tolosa. The existence of the potential voting rights, as well as the other factors described in paragraphs 39 and 40 of IPSAS 6 and paragraphs 20 and 21 of IPSAS 7, are considered and it is determined that Tolosa controls TLM Water Commission. The intention of the Mayor of Tolosa does not influence the assessment.

Example 5A: Financial ability

Entities A and B own 55 per cent and 45 per cent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity C. Entity B also holds debt instruments that are convertible into ordinary shares of Entity C. The debt can be converted at a substantial price, in comparison with Entity B's net assets, at any time and if converted would require Entity B to borrow additional funds to make the payment. If the debt were to be converted, Entity B would hold 70 per cent of the voting rights and Entity A's interest would reduce to 30 per cent.

Although the debt instruments are convertible at a substantial price, they are currently convertible and the conversion feature gives Entity B the power to set the operating and financial policies of Entity C. The existence of the potential voting rights, as well as the other factors described in paragraphs 39 and 40 of IPSAS 6, are considered and it is determined that Entity B, not

Entity A, controls Entity C. The financial ability of Entity B to pay the conversion price does not influence the assessment.

Example 5B: Financial ability

The cities of Melina and Newton own 55 per cent and 45 per cent respectively of the interests that carry voting rights of MN Broadcasting Authority, a public sector entity established by charter to provide broadcasting and television services for the regions. The charter gives the city of Newton the option to buy additional 25 per cent interest of the Authority from the city of Melina at a substantial price, in comparison with the city of Newton's net assets, at any time. If exercised it would require the city of Newton to borrow additional funding to make the payment. If the option were to be exercised, the city of Newton would hold 70 per cent of the voting rights and the city of Melina's interest would reduce to 30 per cent.

Although the option is exercisable at a substantial price, it is currently exercisable and the exercise feature gives the city of Newton the power to set the operating and financial policies of MN Broadcasting Authority. The existence of potential voting rights, as well as the other factors described in paragraphs 39 and 40 of IPSAS 6, are considered and it is determined that the city of Newton, not the city of Melina, controls MN Broadcasting Authority. The financial ability of the city of Newton to pay the exercise price does not influence the assessment.

Comparison with IAS 27

International Public Sector Accounting Standard IPSAS 6, "Consolidated and Separate Financial Statements~~ and Accounting for Controlled Entities~~" is drawn primarily from International Accounting Standard IAS 27, "Consolidated and Separate Financial Statements~~ and Accounting for Investments in Subsidiaries~~" (2003). At the time of issuing this Standard, the IPSASB has not considered the applicability of IFRS 5, "Non-current Assets Held for Sale and Discontinued Operations", to public sector entities, therefore IPSAS 6 does not reflect amendments made to IAS 27 consequent upon the issue of International Financial Reporting Standard IFRS 5. The main differences between IPSAS 6 and IAS 27 are as follows:

- Commentary additional to that in IAS 27 has been included in IPSAS 6 to clarify the applicability of the ~~s~~Standard~~s~~ to accounting by public sector entities.
- IPSAS 6 contains specific guidance on whether control exists in a public sector context (paragraphs 28-41).
- IPSAS 6 uses different terminology, in certain instances, from IAS 27. The most significant examples are the use of the terms ~~"entity",~~ "revenue", "statement of financial performance", "statement of financial position", "net assets/equity", "economic entity", "controlling entity" and "controlled entity" in IPSAS 6. The equivalent terms in IAS 27 are ~~"enterprise",~~ "income", "income statement", "balance sheet", "equity", "group", "parent" and "subsidiary".
- ~~IPSAS 6 contains a different set of definitions of technical terms from IAS 27 (paragraph 8).~~
- IPSAS 6 includes a transitional provision that permits entities to not eliminate all balances and transactions between entities within the economic entity for reporting periods beginning on a date within three years following the date of first adoption of this Standard. IAS 27 does not contain transitional provisions.
- IPSAS 6 contains five additional illustrative examples that reflect the public sector context in Implementation Guidance.

Specific Matters for Comment

The IPSASB would particularly value comments on the following questions. It would be helpful to the IPSASB if these comments indicate the specific paragraph number or groups of paragraphs to which they relate, clearly explain the issue and suggest alternative wording, with supporting reasoning, where this is appropriate.

Question 1

Do you agree that the scope of this proposed IPSAS 7 should not apply to certain investments that otherwise would be associates held by venture capital organizations, mutual funds, unit trusts and similar entities if these investments are measured at fair value in accordance with the relevant international or national accounting standards dealing with financial instruments (see paragraph 1)?

Question 2

Do you agree that an investor need not equity account its investment if all the criteria in paragraph 19 are met?

Question 3

Do you agree that the amount to be reduced to nil when an associate incurs losses should include not only investments in the equity of the associate but also other interests such as long-term receivables (paragraph 36)?

SUMMARY OF MAIN CHANGES IPSAS 7
INVESTMENT IN ASSOCIATES

The main changes proposed are:

Name of Standard

- to change to "Investment in Associates".

Scope

- to now exclude in paragraph 1 investments that would otherwise be associates or joint ventures held by venture capital organizations, mutual funds, unit trusts and similar entities that are measured at fair value in accordance with international and national accounting standards that deal with recognition and measurement of financial instruments.
- to provide exemptions from application of the equity method to certain:
  - controlling entities, similar to those provided for not to prepare consolidated financial statements in IPSAS 6, "Consolidated and Separate Financial Statements" (in paragraph 25(b)); and
  - investors can satisfy the same type of conditions that exempt controlling entities in preparing consolidated financial statements in paragraph 25(c).

Definitions

- to modify the definitions of 'equity method' and 'significant influence' for uniform definitions in IPSASs in paragraph 7.

Significant Influence

- to require in paragraphs 14-16 for an entity to consider the existence and effect of potential voting rights currently exercisable or convertible when assessing whether it has the power to participate in the financial and operating policy decisions of the investee (associate).

Application of the Equity Method

- to clarify in paragraph 19 that investments that are held exclusively with a view to its disposal within twelve months of acquisition and that management is actively seeking a buyer shall be classified as "held for trading" and will be accounted for in accordance with international and national accounting standards that deal with the recognition and measurement of financial instruments.
- to clarify in paragraph 24 that when an investor ceases to significantly influence

its investment, the cost of the investment shall be accounted for in accordance with international and national accounting standards that deal with the recognition and measurement of financial instruments.

- to require in paragraph 29 that surpluses and deficits resulting from ‘upstream’ and ‘downstream’ transactions between an investor and an associate to be eliminated to the extent of the investor’s interest in the associate.
- to allow a maximum of three months between the reporting period of the investor and its associate when applying the equity method (paragraph 32).
- to remove the ‘impracticable’ notion in paragraph 34, such that an investor has to make appropriate adjustments for transactions and other events in the associate’s financial statements when the accounting policies in both entities are not similar.
- to require in paragraphs 36 and 37 to consider the carrying amount of its investment in the equity of the associate and its other long-term interests in the associate when recognizing its share of losses of the associate.

Impairment Losses

- To provide guidance in paragraphs 38-41 on when and how an entity tests for impairment of its associate.

Separate Financial Statements

- to move the requirements and guidance for separate financial statements into IPSAS 6 in paragraphs 42 and 43. Entities will now have to refer to IPSAS 6 for guidance on how to prepare an investor’s separate financial statements.

Disclosure

- to require in paragraph 44 more detailed disclosures on investments in associates, including:
    - nature and extent of any significant restrictions (eg resulting from borrowing arrangements) on the ability of associates to transfer funds to the investor;
    - unrecognized share of losses of an associate if any investor has discontinued recognition of its share of losses of an associate; and
    - the reasons why:
        - an investment is considered to have significantly influence when it holds less than 20 percent of the voting or potential voting power of the investee;
        - an investment is not considered to have significantly influence when it

holds less than 20 percent of the voting or potential voting power of the investee; and

the reporting date of the financial statements of the associate and investor is different.

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD 7—~~ACCOUNTING FOR~~ INVESTMENTS IN ASSOCIATES

CONTENTS

International Public Sector Accounting Standard 7, “Investments in Associates” (IPSAS 7) is set out in paragraphs 1-49 and the Appendix. All the paragraphs have equal authority. IPSAS 7 should be read in the context of the Basis for Conclusion (if any), and the “Preface to the International Public Sector Accounting Standards”. IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD 7—~~ACCOUNTING FOR~~ INVESTMENTS IN ASSOCIATES

~~The standards, which have been set in bold italic type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the "Preface to International Public Sector Accounting Standards". International Public Sector Accounting Standards are not intended to apply to immaterial items.~~

Scope

1. **An entity ~~which~~that prepares and presents financial statements under the accrual basis of accounting shall~~should~~ apply this Standard in accounting by an investor for investments in associates where the investment in the associate leads to the holding of an ownership interest in the form of a shareholding or other formal equity structure. However, it does not apply to investments in associates held by:**

   (a) **venture capital organizations, or**

   (b) **mutual funds, unit trusts and similar entities including investment-linked insurance funds.**

   that are measured at fair value, with changes in fair value recognized in surplus or deficit in the period of the change in accordance with relevant international and national accounting standards dealing with the recognition and measurement of financial instruments.

2. Guidance on recognition and measurement of interests identified in paragraph 1 that are measured at fair value, with changes in fair value recognized in surplus or deficit in the period of the change can be found in the relevant international or national accounting standard dealing with financial instruments.

3. ~~2.~~ This Standard provides the basis for accounting for ownership interests in associates. That is, the investment in the other entity confers on the investor the risks and rewards incidental to an ownership interest. The Standard applies only to investments in the formal equity structure (or its equivalent) of an investee. A formal equity structure means share capital or an equivalent form of unitized capital, such as units in a property trust, but may also include other equity structures in which the investor's interest can be measured reliably. Where the equity structure is poorly defined it may not be possible to obtain a reliable measure of the ownership interest.

4. ~~3.~~ Some contributions made by public sector entities may be referred to as an "investment" but may not give rise to an ownership interest. For example, a public sector entity may make a substantial investment in the development of a hospital that is owned and operated by a charity. Whilst such contributions are non-reciprocal in nature, they allow the public sector entity to participate in the operation of the hospital, and the charity is accountable to the public sector entity for its use of public monies. However, the contributions made by the public sector entity do not constitute an ownership interest, as the charity could seek alternative funding and thereby prevent the public sector entity from participating in the operation of the hospital. Accordingly, the public sector entity is not exposed to the risks nor does it enjoy the rewards which are incidental to an ownership interest.

5. **~~4.~~ This Standard applies to all public sector entities other than Government Business Enterprises.**

6. ~~5.~~ The "Preface to International Public Sector Accounting" Standards issued by the International Public Sector Accounting Standards Board (IPSASB) explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) which are issued by the International Accounting Standards Board. ~~Government Business Enterprises (~~GBEs~~)~~ are defined in IPSAS 1, "Presentation of Financial Statements". ~~required to comply with International Accounting Standards (IASs) issued by the International Accounting Standards Committee. The Public Sector Committee's Guideline No. 1 *Financial Reporting by Government Business Enterprises* notes that IASs are relevant to all business enterprises, regardless of whether they are in the private or public sector. Accordingly, Guideline No. 1 recommends that GBEs should present financial statements that conform, in all material respects, to IASs~~.

Definitions

7. **~~6.~~ The following terms are used in this Standard with the meanings specified:**

~~Accounting policies~~ [deleted]

~~Accrual basis~~ [deleted]

~~Assets~~ [deleted]

Associate is an entity, including an unincorporated entity such as a partnership, over~~in~~ which the investor has significant influence and that~~which~~ is neither a controlled entity nor an interest in a joint venture ~~of the investor~~.

<u>Consolidated financial statements</u> are the financial statements of an economic entity presented as those of a single <u>economic</u> entity.

~~Contributions from owners~~ <u>[deleted]</u>

<u>Control</u> is the power to govern the financial and operating policies of an~~other~~ entity so as to benefit from its activities.

<u>Controlled entity</u> is an entity<u>, including an unincorporated entity such as a partnership,</u> that is subject to the control of another entity (known as the controlling entity).

~~Controlling entity~~ <u>[deleted]</u>

~~Cost method~~ <u>[deleted]</u>

~~Distributions to owners~~ <u>[deleted]</u>

~~Economic entity~~ <u>[deleted]</u>

<u>The</u> ~~E~~<u>e</u><u>quity method</u> is a method of accounting whereby the investment is initially <u>recognized</u>~~recorded~~ at cost and adjusted thereafter for the post-acquisition change in the investor's share of net assets/equity of the investee. The ~~statement of financial performance~~<u>surplus or deficit</u> ~~reflects~~<u>of</u> the <u>investor includes the</u> investor's share of the ~~results of operations~~<u>surplus or deficit</u> of the investee.

~~Expenses~~ <u>[deleted]</u>

~~Fair value~~ <u>[deleted]</u>

~~Government Business Enterprise~~ <u>[deleted]</u>

~~Investor~~ <u>[deleted]</u>

~~Joint venture~~ <u>[deleted]</u>

~~Liabilities~~ <u>[deleted]</u>

~~Net assets/equity~~ <u>[deleted]</u>

~~Reporting date~~ <u>[deleted]</u>

~~Revenue~~ <u>[deleted]</u>

<u>Separate financial statements are those presented by a controlling entity, an investor in an associate or a venturer in a jointly controlled entity, in which the investments are accounted for on the basis of the direct net assets/equity interest rather than on the basis of the reported results and net assets of the investees.</u>

Significant influence (for the purpose of this Standard) is the power to participate in the financial and operating policy decisions of the investee~~,~~ but is not control or joint control over those policies.

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

8. Financial statements in which the equity method is applied are not separate financial statements, nor are the financial statements of an entity that does not have a controlled entity, associate or venturer's interest in a joint venture.

9. Separate financial statements are those presented in addition to consolidated financial statements, financial statements in which investments are accounted for using the equity method and financial statements in which the venturer's interests in joint ventures are proportionately consolidated. Separate financial statements may or may not be appended to, or accompany, those financial statements.

10. Entities that are exempted in accordance with paragraph 16 of IPSAS 6, "Consolidated and Separate Financial Statements" from consolidation, paragraph 3 of IPSAS 8, "Interests in Joint Ventures" from applying proportionate consolidation or paragraph 19(c) of this Standard from applying the equity method may present separate financial statements as their only financial statements.

~~*Cost Method*~~ **[deleted]**

~~7.~~ [deleted]

~~*Economic Entity*~~ **[deleted]**

~~8.~~ [deleted]

~~9.~~ [deleted]

~~*Future Economic Benefits or Service Potential*~~ **[deleted]**

~~12.~~ [deleted]

~~*Government Business Enterprises*~~ **[deleted]**

~~13.~~ [deleted]

~~*Net Assets/Equity*~~ [deleted]

~~14.~~ [deleted]

Significant Influence

11. ~~15.~~ Whether an investor has significant influence over the investee is a matter of judgment based on the nature of the relationship between the investor and the investee, and on the definition of significant influence in this Standard. This Standard applies only to those associates in which an entity holds an ownership interest.

12. ~~16.~~ The existence of significant influence by an investor is usually evidenced in one or more of the following ways:

(a) representation on the board of directors or equivalent governing body of the investee;

(b) participation in policy-making processes, including participation in decisions about dividends or other distributions;

(c) material transactions between the investor and the investee;

(d) interchange of managerial personnel; or

(e) provision of essential technical information.

13. ~~17.~~ If the investor's ownership interest is in the form of shares and it holds, directly or indirectly (eg through controlled entities), 20~~%~~ per cent or more of the voting power of the investee, it is presumed that the investor does have significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly (eg through controlled entities), less than 20~~%~~ per cent of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.

14. An entity may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or other similar instruments that have the potential, if exercised or converted, to give the entity additional voting power or reduce another party's voting power over the financial and operating policies of another entity (ie potential voting rights). The existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by other entities, are considered when assessing whether an entity has significant influence. Potential voting rights are not currently exercisable or convertible when, for example, they cannot be exercised or converted until a future date or until the occurrence of a future event.

15. In assessing whether potential voting rights contribute to significant influence, the entity examines all facts and circumstances (including the terms of

exercise of the potential voting rights and any other binding arrangements whether considered individually or in combination) that affect potential rights, except the intention of management and the financial ability to exercise or convert.

16. An entity loses significant influence over an investee when it loses the power to participate in the financial and operating policy decisions of that investee. The loss of significant influence can occur with or without a change in absolute or relative ownership levels. It could occur, for example, when an associate becomes subject to the control of another government, a court, administrator or regulator. It could also occur as a result of a binding agreement.

Equity Method

17. ~~11.~~ Under the equity method, the investment in an associate is initially ~~recorded~~recognized at cost and the carrying amount is increased or decreased to recognize the investor's share of ~~net~~ surplus~~es~~ or deficit~~s~~ of the investee after the date of acquisition. The investor's share of the surplus or deficit of the investee is recognized in the investor's surplus or deficit. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for ~~alterations~~changes in the investor's proportionate interest in the investee arising from changes in the investee's equity that have not been recognized~~included~~ in the investee's surplus or deficit~~statement of financial performance~~. Such changes include those arising from the revaluation of property, plant, equipment and ~~investments,~~ from foreign exchange translation differences~~ and from the adjustment of differences arising from business combinations~~. The investor's share of those changes is recognized directly in net assets/equity of the investor.

18. When potential voting rights exist, the investor's share of surplus or deficit of the investee and of changes in the investee's net assets/equity is determined on the basis of present ownership interests and does not reflect the possible exercise or conversion of potential voting rights.

~~Consolidated Financial Statements~~Application of the Equity Method

19. ~~18.~~ **An investment in an associate ~~should~~shall be accounted for ~~in consolidated financial statements~~ using ~~under~~ the equity method except when:**

(a) **there is evidence that the investment is acquired and held exclusively with a view to its disposal ~~in the near future, in which case it should be accounted for under the cost method~~ within**

twelve months from acquisition and that management is actively seeking a buyer~~.~~;

(b) **the exception in paragraph 16 of IPSAS 6, allowing a controlling entity that also has an investment in an associate not to present consolidated financial statements, applies; or**

(c) **all of the following apply:**

(i) **the investor is:**

- **a wholly-owned controlled entity and users of financial statements prepared by applying the equity method are unlikely to exist or their information needs are met by the controlling entity's consolidated financial statements, or ~~is~~**

- **a partially-owned controlled entity of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the investor not applying the equity method;**

(ii) **the investor's 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) **the investor 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) **the ultimate or any intermediate controlling entity of the investor produces consolidated financial statements available for public use that comply with International Public Sector Accounting Standards.**

20. **Investments described in paragraph 19(a) shall be accounted for in accordance with international and national accounting standards dealing with the recognition and measurement of financial instruments.**

21. When an investment in an associate previously accounted for in accordance with international and national accounting standards that deal with the recognition and measurement of financial instruments is not disposed of within twelve months, it shall be accounted for using the equity method as from the date of acquisition. Financial statements for the periods since acquisition shall be restated.

22. Exceptionally, an entity may have found a buyer for an associate described in paragraph 19(a), but may not have completed the sale within twelve months because of the need for approval by regulators or others. The entity is not required to apply the equity method to an investment in such an associate if the sale is in process at the reporting date and there is no reason to believe that it will not be completed shortly after the reporting date.

23. ~~19.~~ The recognition of revenue on the basis of distributions received may not be an adequate measure of the revenue earned by an investor on an investment in an associate because the distributions received may bear little relationship to the performance of the associate. In particular, where the associate has not-for-profit objectives, investment performance will be determined by factors such as the cost of outputs and overall service delivery. ~~As~~Because the investor has significant influence over the associate, the investor has an interest in ~~measure of responsibility for~~ the associate's performance and, as a result, the return on its investment. The investor accounts for this ~~stewardship~~interest by extending the scope of its ~~consolidated~~ financial statements to include its share of ~~net~~ surpluses or deficits of such an associate~~ and so provides an analysis of earnings and investment from which more useful ratios can be calculated~~. As a result, ~~the~~ application of the equity method provides more informative reporting of the net assets/equity and ~~net~~ surplus or deficit of the investor.

~~20.~~ [deleted]

24. ~~21.~~ **An investor ~~should~~ shall discontinue the use of the equity method from the date that~~:~~**

~~(a)~~ it ceases to have significant influence ~~in~~over an associate and shall account for the investment in accordance with international and national accounting standards that deal with recognition and measurement of financial instruments from that date, provided the associate does not become a controlled entity or a joint venture as defined in IPSAS 8.~~but retains, either in whole or in part, its investment; or~~

~~(b) the use of the equity method is no longer appropriate because the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds or provide other non-financial benefits to, or on behalf of, the investor.~~

~~The carrying amount of the investment at that date should be regarded as cost thereafter.~~

25. **The carrying amount of the investment at the date that it ceases to be an associate shall be regarded as its cost on initial measurement as a financial asset in accordance with international and national accounting**

standards that deal with the recognition and measurement of financial instruments.

~~22.~~ [deleted]

~~Separate Financial Statements of the Investor~~ [moved to paragraphs 41-42]

~~23.~~ [deleted]

~~24.~~ [deleted]

~~25.~~ [deleted]

~~26.~~ [deleted]

~~27.~~ [deleted]

~~28.~~ [deleted]

~~Application of the Equity Method~~

26. ~~29.~~ Many of the procedures appropriate for the application of the equity method are similar to the consolidation procedures ~~set out~~described in IPSAS 6. Furthermore, the ~~broad~~ concepts underlying the ~~consolidation~~ procedures used in ~~the~~ accounting for the acquisition of a controlled entity are also adopted ~~on~~in the accounting for the acquisition of an investment in an associate.

~~30.~~ [deleted]

27. An economic entity's share in an associate is the aggregate of the holdings in that associate by the controlling entity and its controlled entities. The holdings of the economic entity's other associates or joint ventures are ignored for this purpose. When an associate has controlled entities, associates, or joint ventures the surpluses or deficits and net assets taken into account in applying the equity method are those recognized in the associate's financial statements (including the associate's share of the surpluses or deficits and net assets of its associates and joint ventures), after any adjustments necessary to give effect to uniform accounting policies (see paragraphs 31 and 33).

28. Surpluses and deficits resulting from 'upstream' and 'downstream' transactions between an investor (including its consolidated controlled entities) and an associate are recognized in the investor's financial statements only to the extent of unrelated investors' interests in the associate. 'Upstream' transactions are, for example, sales of assets from an associate to the investor. 'Downstream' transactions are, for example, sales of assets from the investor to an associate. The investor's share in the associate's surpluses and deficits resulting from these transactions is eliminated.

29. ~~31.~~ An investment in an associate is accounted for ~~under~~using the equity method from the date on which it ~~falls within the definition of~~becomes an associate. Guidance on accounting for any difference (whether positive or negative) between the cost of acquisition and the investor's share of the fair values of the net identifiable assets of the associate is treated as goodwill (guidance can be found in ~~I~~international or national ~~A~~accounting ~~S~~standards ~~IAS 22, "~~ dealing with ~~B~~business ~~C~~combinations~~"~~). Goodwill relating to an associate is included in the carrying amount of the investment. Appropriate adjustments to the investor's share of the surpluses or deficits after acquisition are made to account, for example,~~:~~

~~(a)~~ for depreciation of the depreciable assets, based on their fair values at the date of acquisition.~~; and~~

~~(b) amortization of the difference between the cost of the investment and the investor's share of the fair values of the net identifiable assets.~~

30. ~~**32.**~~ **The most recent available financial statements of the associate are used by the investor in applying the equity method~~; they are usually drawn up to the same date as the financial statements of the investor~~. When the reporting dates of the investor and the associate are different, the associate ~~often~~ prepares, for the use of the investor, financial statements as ~~at~~of the same date as the financial statements of the investor, unless~~.~~ ~~When~~ it is impracticable to do so~~this, financial statements drawn up to a different reporting date may be used. The consistency principle dictates that the length of the reporting periods, and any difference in the reporting dates, are consistent from period to period~~.**

31. ~~**33.**~~ **When, in accordance with paragraph 30, the financial statements of an associate used in applying the equity method are prepared as of ~~with~~ a different reporting date from that of the investor ~~are used~~, adjustments ~~are~~shall be made for the effects of ~~any~~ significant ~~events or~~ transactions or events ~~between the investor and the associate~~ that occur between ~~the~~that date ~~of the associate's financial statements~~ and the date of the investor's financial statements. In any case, the difference between the reporting date of the associate and that of the investor shall be no more than three months. The length of the reporting periods and any difference in the reporting dates shall be the same from period to period.**

32. ~~**34.**~~ **The investor's financial statements ~~are~~shall be ~~usually~~ prepared using uniform accounting policies for like transactions and events in similar circumstances.**

33. ~~In many cases, i~~If an associate uses accounting policies other than those adopted by the investor for like transactions and events in similar circumstances, ~~appropriate~~ adjustments ~~are~~shall be made to conform the associate's accounting policies to those of the investor when the associate's financial statements ~~when they~~ are used by the investor in applying the equity method. ~~If it is not practicable for such adjustments to be calculated, that fact is generally disclosed.~~

34. If an associate has outstanding cumulative preferred shares~~,~~ that are held by ~~outside interests~~parties other than the investor and classified as net assets/equity, the investor computes its share of ~~net~~ surpluses or deficits after adjusting for the ~~preferred~~ dividends on such shares, whether or not the dividends have been declared.

35. If~~, under the equity method,~~ an investor's share of deficits of an associate equals or exceeds ~~the carrying amount of an investment~~its interest in the associate, the investor ~~ordinarily~~ discontinues recognizing~~including~~ its share of further losses. The interest in an associate is the carrying amount of the investment in the associate under the equity method together with any long-term interests that, in substance, form part of the investor's net investment in the associate. For example, an item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, an extension of the entity's investment in that associate. Such items may include preference shares and long-term receivables or loans but do not include trade receivables, trade payables or any long-term receivables for which adequate collateral exists, such as secured loans. Losses recognized under the equity method in excess of the investor's investment in ordinary shares are applied to the other components of the investor's interest in an associate in the reverse order of their seniority (ie priority of liquidation).

36. After the investor's interest is reduced to zero~~The investment is reported at nil value~~,~~.~~ ~~A~~additional losses are provided for, and a liability is recognized, only to the extent that the investor has incurred legal or constructive obligations or made payments on behalf of the associate ~~to satisfy obligations of the associate that the investor has guaranteed or otherwise committed~~. If the associate subsequently reports surpluses, the investor resumes ~~including~~recognizing its share of those surpluses only after its share of surpluses equals the share of ~~net~~ deficits not recognized.

Impairment Losses

37. After application of the equity method, including recognizing the associate's losses in accordance with paragraph 35, the investor applies the requirements of international and national accounting standards that deal with the recognition and measurement of financial instruments to determine whether it

is necessary to recognize any additional impairment loss with respect to the investor's net investment in the associate.

38. The investor also applies the requirements of international and national accounting standards that deal with the recognition and measurement of financial instruments to determine whether any additional impairment loss is recognized with respect to the investor's interest in the associate that does not constitute part of the net investment and the amount of the impairment loss.

39. ~~37.~~ If application of the requirements of international and national accounting standards that deal with the recognition and measurement of financial instruments ~~there is an~~ indicat~~ion~~es that ~~an~~the investment is~~n an associate may be~~ impaired, an entity applies International Public Sector Accounting Standard (IPSAS) 21, "Impairment of Non-Cash Generating Assets".~~should consider the relevant international and/or national standards on accounting for such an impairment~~. IPSAS 21 directs an entity to refer IAS 36 to determine the value in use of the cash-generating investment. Based on IAS 36, an entity estimates:

(a) its share of the present value of the estimated future cash flows expected to the generated by the investee, including the cash flows from the operations of the investee and the proceeds on the ultimate disposal of the investment; or

(b) the present value of the estimated future cash flows expected to arise from dividends to be received from the investment and from its ultimate disposal.

Under appropriate assumptions, both methods give the same result. Any resulting impairment loss for the investment is allocated in accordance with IAS 36. Therefore, it is allocated first to any remaining goodwill (see paragraph 28).

40. The recoverable amount of an investment in an associate is assessed for each associate, unless the associate does not generate cash inflows from continuing use that are largely independent of those from other assets of the entity.

~~Income Taxes~~ [deleted]

~~38.~~ [deleted]

Separate Financial Statements

41. An investment in an associate shall be accounted for in the investor's separate financial statements in accordance with paragraphs 58-64 of IPSAS 6.

42. This Standard does not mandate which entities produce separate financial statements available for public use.

~~Contingencies~~ Disclosure

~~**40. The following disclosures should be made:**~~

~~**(a) an appropriate listing and description of significant associates including the proportion of ownership interest and, if different, the proportion of voting power held; and**~~

~~**(b) the methods used to account for such investments.**~~

43. **The following disclosures shall be made:**

(a) **the fair value of investments in associates for which there are published price quotations;**

(b) **summarized financial information of associates, including the aggregated amounts of assets, liabilities, revenues and surplus or deficit;**

(c) **the reasons why the presumption that an investor does not have significant influence is overcome if the investor holds, directly or indirectly through controlled entities, less than 20 per cent of the voting or potential voting power of the investee but concludes that it has significant influence;**

(d) **the reasons why the presumption that an investor has significant influence is overcome if the investor holds, directly or indirectly through controlled entities, 20 per cent or more of the voting power of the investee but concludes that it does not have significant influence;**

(e) **the reporting date of the financial statements of an associate, when such financial statements are used in applying the equity method and are as of a reporting date or for a period that is different from that of the investor, and the reason for using a different reporting date or different period;**

(f) **the nature and extent of any significant restrictions (eg resulting from borrowing arrangements or regulatory requirements) on the ability of associates to transfer funds to the investor in the form of cash dividends, or repayment of loans or advances;**

(g) **the unrecognized share of losses of an associate, both for the period and cumulatively, if an investor has discontinued recognition of its share of losses of an associate;**

(h) **the fact that an associate is not accounted for using the equity method in accordance with paragraph 19; and**

(i) **summarized financial information of associates, either individually or in groups, that are not accounted for using the equity method, including the amounts of total assets, total liabilities, revenues and surpluses or deficits.**

44. ~~41.~~ **Investments in associates accounted for using the equity method ~~should~~shall be classified as non-current assets ~~and disclosed as a separate item in the statement of financial position~~. The investor's share of the ~~net~~ surpluses or deficits of such associates, and the carrying amount of these investments ~~should~~shall be separately disclosed ~~as a separate item in the statement of financial performance~~. The investor's share of any ~~extraordinary or prior period items~~ discontinuing operations of such associates ~~should~~shall also be separately disclosed.**

45. **The investor's share of changes recognized directly in the associate's net assets/equity shall be recognized directly in net assets/equity by the investor and shall be disclosed in the statement of changes in equity as required by International Public Sector Accounting Standard IPSAS 1, "Presentation of Financial Statements".**

46. ~~39.~~ **In accordance with ~~the appropriate standards that address provisions, contingent liabilities and contingent assets~~International Public Sector Accounting Standard IPSAS 19, "Provisions, Contingent Liability and Contingent Assets", the investor shall disclose~~s~~:**

(a) **its share of the contingent liabilities of an associate incurred jointly with other investors~~for which it is also contingently liable~~; and**

(b) **those contingent liabilities that arise because the investor is severally liable for all or part of the liabilities of the associate.~~; and~~**

~~**(c) its share of the contingent assets of an associate.**~~

~~42.~~ [deleted]

Effective Date

47. ~~43.~~ **An entity shall apply t~~T~~his International Public Sector Accounting Standard ~~becomes effective~~ for annual ~~financial statements covering~~ periods beginning on or after ~~1~~DD ~~July~~MM ~~2001~~YYYY. Earlier application is encouraged. If an entity applies this Standard for a period beginning before DD MM YYYY, it shall disclose that fact.**

48. ~~44.~~ When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, 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 7 (2000)

49. This Standard supersedes IPSAS 7, "Accounting for Investments in Associates" issued in 2000.

Appendix

Amendments to Other Pronouncements

The amendments in this appendix shall be applied for annual periods beginning on or after DD MM YYY. If an entity applies this Standard for an earlier period, these amendments shall be applied for that earlier period.

In International Public Sector Accounting Standards, applicable at MM YYY, references to the current version of IPSAS 7, “Accounting for Investments in Associates” are amended to IPSAS 7, “Investments in Associates”.

Comparison with IAS 28

International Public Sector Accounting Standard IPSAS 7 ~~*Accounting for*~~ "Investments in Associates" (Revised 2003) is drawn primarily from International Accounting Standard IAS 28, ~~*Accounting for*~~ "Investments in Associates" (Revised 2003). At the time of issuing this Standard, the IPSASB has not considered the applicability of IFRS 3, "Business Combinations" and IFRS 5, "Non-current Assets Held for Sale and Discontinued Operations" to public sector entities. Therefore, IPSAS 7 does not reflect amendments made to IAS 27 consequent upon the issue of those Standards. The main differences between IPSAS 7 and IAS 28 are as follows:

- Commentary additional to that in IAS 28 has been included in IPSAS 7 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 7 applies to all investments in associates where the investor holds an ownership interest in the associate in the form of a shareholding or other formal equity structure. IAS 28 does not contain similar ownership interest requirements. However, it is unlikely that equity accounting could be applied unless the associate had a formal or other reliably measurable equity structure.
- IPSAS 7 uses different terminology, in certain instances, from IAS 28. The most significant examples are the use of the terms ~~"entity",~~ "revenue", "statement of financial performance", "statement of financial position" and "net assets/equity" in IPSAS 7. The equivalent terms in IAS 28 are ~~"enterprise",~~ "income", "income statement", "balance sheet" and "equity".
- IPSAS 7 contains a different set of definitions of technical terms from IAS 28 (paragraph ~~6~~7).~~In common with IAS 28 this Standard allows an investment in an associate that is included in the separate financial statements of an investor that issues consolidated financial statements, to be carried at cost or accounted for using the equity method. International Accounting Standard IAS 28 also allows such investments in associates to be accounted for as an available-for-sale financial asset as described in International Accounting Standard IAS 39, *Financial Instruments: Recognition and Measurement*. By contrast this Standard allows such investments to be accounted for in the same way as other investments shown in the financial statements of the investor.~~

Specific Matters for Comment

The IPSASB would particularly value comments on the following questions. It would be helpful to the IPSASB if these comments indicate the specific paragraph number or groups of paragraphs to which they relate, clearly explain the issue and suggest alternative wording, with supporting reasoning, where this is appropriate.

Question 1

Do you agree that the scope of this proposed IPSAS 8 should not apply to certain investments that otherwise would be joint ventures held by venture capital organizations, mutual funds, unit trusts and similar entities if these investments are measured at fair value in accordance with the relevant international or national accounting standards dealing financial instruments (see paragraph 1)?

Question 2

Do you agree that a venturer need not either proportionate consolidate or equity account its joint venture if all the criteria in paragraph 3 are met?

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD 8—INTERESTS IN JOINT VENTURERS

CONTENTS

International Public Sector Accounting Standard 8, "Interests in Joint Ventures" (IPSAS 8) is set out in paragraphs 1-71 and the Appendix. All the paragraphs have equal authority. IPSAS 8 should be read in the context of the Basis for Conclusion (if any), and the "Preface to International Public Sector Accounting Standards". IPSAS 3, "Accounting Policies, Changes in Accounting Estimates and Errors" provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD 8—INTERESTS IN JOINT VENTURERS

~~The standards, which have been set in bold italic type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the "Preface to International Public Sector Accounting Standards". International Public Sector Accounting Standards are not intended to apply to immaterial items.~~

Scope

1. **An entity ~~which~~that prepares and presents financial statements under the accrual basis of accounting ~~should~~ shall apply this Standard in accounting for interests in joint ventures and the reporting of joint venture assets, liabilities, revenue and expenses in the financial statements of venturers and investors, regardless of the structures or forms under which the joint venture activities take place. However, it does not apply to venturers' interests in jointly controlled entities held by:**

   (a) **venture capital organizations, or**

   (b) **mutual funds, unit trusts and similar entities including investment-linked insurance funds.**

   that are measured at fair value, with changes in fair value recognized in surplus or deficit in the period of the change in accordance with the relevant international or national accounting standard dealing with financial instruments.

2. Guidance on recognition and measurement of interests identified in paragraph 1 that are measured at fair value, with changes in fair value recognized in surplus or deficit in the period of the change can be found in the relevant international or national accounting standard dealing with financial instruments.

3. **A venturer with an interest in a jointly controlled entity is exempted from paragraphs 35 (proportionate consolidation) and 43 (equity method) when it meets the following conditions:**

   (a) **there is evidence that the interest is acquired and held exclusively with a view to its disposal within twelve months from acquisition and that management is actively seeking a buyer ;**

(b) **the exception in paragraph 16 of IPSAS 6 Consolidated and Separate Financial Statements allowing a controlling entity that also has an interest in a jointly controlled entity not to present consolidated financial statements is applicable; or**

(c) **all of the following apply:**

(i) **the venturer is:**

(A) a wholly-owned controlled entity and users of financial statements prepared by applying proportionate consolidation or the equity method are unlikely to exist or their information needs are met by the controlling entity's consolidated financial statements; or

(B) a partially-owned controlled entity of another entity and its owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the venturer not applying proportionate consolidation or the equity method;

(ii) **the venturer's 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) **the venturer 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) **the ultimate or any intermediate controlling entity of the venturer produces consolidated financial statements available for public use that comply with International Public Sector Accounting Standards.**

~~2. This Standard provides the basis for accounting for interests in joint ventures.~~

~~3~~4. **This Standard applies to all public sector entities other than Government Business Enterprises.**

~~4~~5. The "Preface to International Public Sector Accounting Standards" issued by the International Public Sector Accounting Standards Board (IPSASB) explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) ~~which~~ are issued by the International Accounting Standards Board (IASB). ~~Government Business Enterprises (~~GBEs~~)~~ are defined in IPSAS 1, "Presentation of Financial

Statements”.~~required to comply with~~ ~~and International Accounting Standards (IASs) issued by the International Accounting Standards Committee. The Public Sector Committee’s Guideline No. 1 *Financial Reporting by Government Business Enterprises* notes that IASs are relevant to all business enterprises, regardless of whether they are in the private or public sector. Accordingly, Guideline No.1 recommends that GBEs should present financial statements that conform, in all material respects, to IASs.~~

Definitions

~~5~~6. **The following terms are used in this Standard with the meanings specified:**

~~Accrual basis~~ [deleted]

~~Assets~~ [deleted]

~~Associate~~ [deleted]

~~Cash~~ [deleted]

~~Cash flows~~ [deleted]

Consolidated financial statements are the financial statements of an economic entity presented as those of a single entity.

~~Contributions from owners~~ [deleted]

Control is the power to govern the financial and operating policies of another entity so as to benefit from its activities.

~~Controlled entity~~ [deleted]

~~Controlling entity~~ [deleted]

~~Distributions to owners~~ [deleted]

~~Economic entity~~ [deleted]

Equity method (for the purpose of this Standard) is a method of accounting ~~and reporting~~ whereby an interest in a jointly controlled entity is initially recorded at cost and adjusted thereafter for the post-acquisition change in the venturer’s share of net assets/equity of the jointly controlled entity. The ~~statement of financial performance reflects~~ surplus or deficit of the venturer includes the venturer’s share of the ~~results of operations~~ surplus or deficit of the jointly controlled entity.

~~Expenses~~ [deleted]

~~(e)Government Business Enterprise~~ [deleted]

Investor in a joint venture is a party to a joint venture and does not have joint control over that joint venture.

Joint control is the agreed sharing of control over an activity by a binding arrangement.

Joint venture is a binding arrangement whereby two or more parties are committed to undertake an activity ~~which~~ that is subject to joint control.

~~Liabilities~~ [deleted]

Proportionate consolidation is a method of accounting ~~and reporting~~ whereby a venturer's share of each of the assets, liabilities, revenue and expenses of a jointly controlled entity is combined ~~on a~~ line-by-line ~~basis~~ with similar items in the venturer's financial statements or reported as separate line items in the venturer's financial statements.

~~Revenue~~ [deleted]

Separate financial statements are those presented by a controlling entity, an investor in an associate or a venturer in a jointly controlled entity, in which the investments are accounted for on the basis of the direct net assets/equity interest rather than on the basis of the reported results and net assets of the investees.

Significant influence (for the purpose of this Standard) is the power to participate in the financial and operating policy decisions of an activity but is not control or joint control over those policies.

Venturer is a party to a joint venture and has joint control over that joint venture.

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

Binding Arrangement

~~6~~7. The existence of a binding arrangement distinguishes interests ~~which~~ that involve joint control from investments in associates ~~where~~ in which the investor has significant influence (see International Public Sector Accounting Standard (IPSAS) 7, "~~Accounting for~~ Investments in Associates"). For the purposes of this Standard, an arrangement includes all binding arrangements between venturers. That is, in substance, the arrangement confers similar rights and obligations on the parties to it as if it were in the form of a contract.

For instance, two government departments may enter into a formal arrangement to undertake a joint venture but the arrangement may not constitute a legal contract because, in that jurisdiction, individual departments may not be separate legal entities with the power to contract. Activities ~~which~~ that have no binding arrangement to establish joint control are not joint ventures for the purposes of this Standard.

~~7~~8. The binding arrangement may be evidenced in a number of ways, for example by a contract between the venturers or minutes of discussions between the venturers. In some cases, the binding arrangement is incorporated in the enabling legislation, articles or other by-laws of the joint venture. Whatever its form, the arrangement is usually in writing and deals with such matters as:

(a) the activity, duration and reporting obligations of the joint venture;

(b) the appointment of the board of directors or equivalent governing body of the joint venture and the voting rights of the venturers;

(c) capital contributions by the venturers; and

(d) the sharing by the venturers of the output, revenue, expenses, surpluses or deficits, or cash flows of the joint venture.

~~8~~9. The binding arrangement establishes joint control over the joint venture. Such a requirement ensures that no single venturer is in a position to ~~unilaterally~~ control the activity unilaterally. The arrangement identifies those decisions in areas essential to the goals of the joint venture which require the consent of all the venturers and those decisions which may require the consent of a specified majority of the venturers.

~~9~~10. The binding arrangement may identify one venturer as the operator or manager of the joint venture. The operator does not control the joint venture but acts within the financial and operating policies ~~which~~ that have been agreed by the venturers in accordance with the arrangement and delegated to the operator. If the operator has the power to govern the financial and operating policies of the activity, it controls the venture and the venture is a controlled entity of the operator and not a joint venture.

~~Economic Entity~~ [deleted]

~~10~~ [deleted]

~~11~~ [deleted]

~~12~~ [deleted]

Forms of Joint Venture

~~13~~11. Many public sector entities establish joint ventures to undertake a variety of activities. The nature of these activities ranges from commercial undertakings to provision of community services at no charge. The terms of a joint venture are set out in a contract or other binding arrangement and usually specify the initial contribution from each joint venturer and the share of revenues or other benefits (if any), and expenses of each of the joint venturers.

~~14~~12. Joint ventures take many different forms and structures. This Standard identifies three broad types — jointly controlled operations, jointly controlled assets and jointly controlled entities ~~which~~that are commonly described as, and meet the definition of, joint ventures. The following characteristics are common to all joint ventures:

(a) two or more venturers are bound by a~~n~~ binding arrangement; and

(b) the binding arrangement establishes joint control.

Joint Control

13. Joint control may be precluded when a joint venture is in legal reorganization or in bankruptcy, is subject to an administrative restructuring of government arrangements, or operates under severe long-term restrictions on its ability to transfer funds to the venturer. If joint control is continuing, these events are not enough in themselves to justify not accounting for joint ventures in accordance with this Standard.

Separate Financial Statements

14. Financial statements in which proportionate consolidation or the equity method is applied are not separate financial statements, nor are the financial statements of an entity that does not have a controlled entity, associate or venturer's interest in a jointly controlled entity.

15. Separate financial statements are those presented in addition to consolidated financial statements, financial statements in which investments are accounted for using the equity method and financial statements in which venturers' interests in joint ventures are proportionately consolidated. Separate financial statements need not be appended to, or accompany, those statements.

16. Entities that are exempted in accordance with paragraph 16 of IPSAS 6 from consolidation, paragraph 19(c) of IPSAS 7, "Investments in Associates" from applying the equity method or paragraph 3 of this Standard from applying proportionate consolidation or the equity method may present separate financial statements as their only financial statements.

~~Future Economic Benefits or Service Potential~~ [deleted]

~~15.~~ [deleted]

~~Government Business Enterprises~~[deleted]

16. [deleted]

Jointly Controlled Operations

~~18~~17. The operation of some joint ventures involves the use of the assets and other resources of the venturers rather than the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves. Each venturer uses its own property, plant and equipment and carries its own inventories. It also incurs its own expenses and liabilities and raises its own finance, which represent its own obligations. The joint venture activities may be carried out by the venturer's employees alongside the venturer's similar activities. The joint venture agreement usually provides a means by which the revenue from the sale or provision of the joint product or service and any expenses incurred in common are shared among the venturers.

~~19~~18. An example of a jointly controlled operation is when two or more venturers combine their operations, resources and expertise ~~in order~~ to manufacture, market and distribute jointly a particular product, such as an aircraft. Different parts of the manufacturing process are carried out by each of the venturers. Each venturer bears its own costs and takes a share of the revenue from the sale of the aircraft, such share being determined in accordance with the binding arrangement. A further example is when two entities combine their operations, resources and expertise ~~in order~~ to jointly deliver a service, such as aged care where, in accordance with an agreement, a local government offers domestic services and a local hospital offers medical care. Each venturer bears its own costs and takes a share of revenue, such as user charges and government grants; such share being determined in accordance with the binding agreement.

~~20~~19. **In respect of its interests in jointly controlled operations, a venturer ~~should~~ shall recognize in its ~~separate~~ financial statements ~~and consequently in its consolidated financial statements~~:**

(a) **the assets that it controls and the liabilities that it incurs; and**

(b) **the expenses that it incurs and its share of the revenue that it earns from the sale or provision of goods or services by the joint venture.**

~~21~~20. Because the assets, liabilities, revenue (if any) and expenses are already recognized in the ~~separate~~ financial statements of the venturer, ~~and consequently in its consolidated financial statements,~~ no adjustments or other consolidation procedures are required in respect of these items when the venturer presents consolidated financial statements.

~~22~~21. Separate accounting records may not be required for the joint venture itself and financial statements may not be prepared for the joint venture. However, the venturers may prepare management accounts so that they may assess the performance of the joint venture.

Jointly Controlled Assets

~~23~~22. Some joint ventures involve the joint control, and often the joint ownership by the venturers, of one or more assets contributed to, or acquired for the purpose of, the joint venture and dedicated to the purposes of the joint venture. The assets are used to obtain benefits for the venturers. Each venturer may take a share of the output from the assets and each bears an agreed share of the expenses incurred.

~~24~~23. These joint ventures do not involve the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves. Each venturer has control over its share of future economic benefits or service potential through its share ~~in~~ of the jointly controlled asset.

~~25~~24. Some activities in the public sector involve jointly controlled assets. For example, a local government may enter into an arrangement with a private sector corporation to construct a toll road. The road provides the citizens with improved access between the local government's industrial estate and its port facilities. The road also provides the private sector corporation with direct access between its manufacturing plant and the port. The agreement between the local authority and the private sector corporation specifies each party's share of revenues and expenses associated with the toll road. Accordingly, each venturer derives economic benefits or service potential from the jointly controlled asset and bears an agreed proportion of the costs of operating the road. Similarly, many activities in the oil, gas and mineral extraction industries involve jointly controlled assets~~;~~. ~~f~~For example, a number of oil production companies may jointly control and operate an oil pipeline. Each venturer uses the pipeline to transport its own product in return for which it bears an agreed proportion of the expenses of operating the pipeline. Another example of a jointly controlled asset is when two entities jointly control a property, each taking a share of the rents received and bearing a share of the expenses.

~~26~~25. **In respect of its interest in jointly controlled assets, a venturer ~~should~~ shall recognize in its ~~separate~~ financial statements ~~and consequently in its consolidated financial statements~~:**

(a) **its share of the jointly controlled assets, classified according to the nature of the assets;**

(b) **any liabilities ~~which~~ that it has incurred;**

(c) **its share of any liabilities incurred jointly with the other venturers in relation to the joint venture;**

(d) **any revenue from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and**

(e) **any expenses ~~which~~ that it has incurred in respect of its interest in the joint venture.**

~~27~~26. In respect of its interest in jointly controlled assets, each venturer includes in its accounting records and recognizes in its ~~separate~~ financial statements ~~and consequently in its consolidated financial statements~~:

~~(b)~~(a) its share of the jointly controlled assets, classified according to the nature of the assets rather than as an investment. For example, a share of a jointly controlled road is classified as property, plant and equipment~~;~~.

~~(c)~~(b) any liabilities ~~which~~ that it has incurred, for example those incurred in financing its share of the assets~~;~~.

~~(d)~~(c) its share of any liabilities incurred jointly with other venturers in relation to the joint venture~~;~~.

~~(e)~~(d) any revenue from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture~~; and~~.

(e) any expenses ~~which~~ that it has incurred in respect of its interest in the joint venture, for example those related to financing the venturer's interest in the assets and selling its share of the output.

~~28~~27. Because the assets, liabilities, revenue and expenses are ~~already~~ recognized in the ~~separate~~ financial statements of the venturer, ~~and consequently in its consolidated financial statements,~~ no adjustments or other consolidation procedures are required in respect of these items when the venturer presents consolidated financial statements.

~~29~~28. The treatment of jointly controlled assets reflects the substance and economic reality and, usually, the legal form of the joint venture. Separate accounting records for the joint venture itself may be limited to those expenses incurred in common by the venturers and ultimately borne by the venturers according to their agreed shares. Financial statements may not be prepared for the joint venture, although the venturers may prepare management accounts so that they may assess the performance of the joint venture.

Jointly Controlled Entities

~~30~~29. A jointly controlled entity is a joint venture ~~which~~ that involves the establishment of a corporation, partnership or other entity in which each venturer has an interest. The entity operates in the same way as other entities, except that a~~n~~ binding arrangement between the venturers establishes joint control over the activity of the entity.

~~31~~30. A jointly controlled entity controls the assets of the joint venture, incurs liabilities and expenses and earns revenue. It may enter into contracts in its own name and raise finance for the purposes of the joint venture activity. Each venturer is entitled to a share of the ~~results~~ surpluses of the jointly controlled entity, although some jointly controlled entities also involve a sharing of the output of the joint venture.

~~32~~31. A common example of a jointly controlled entity is when two entities combine their activities in a particular line of service delivery by transferring the relevant assets and liabilities into a jointly controlled entity. Another example arises when an entity commences a business in a foreign country in conjunction with a government or other agency in that country, by establishing a separate entity ~~which~~ that is jointly controlled by the entity and the government or agency in the foreign country.

~~33~~32. Many jointly controlled entities are similar in substance to those joint ventures referred to as jointly controlled operations or jointly controlled assets. For example, the venturers may transfer a jointly controlled asset, such as a road, into a jointly controlled entity, for tax or other reasons. Similarly, the venturers may contribute into a jointly controlled entity~~,~~ assets ~~which~~ that will be operated jointly. Some jointly controlled operations also involve the establishment of a jointly controlled entity to deal with particular aspects of the activity, for example, the design, marketing, distribution or after-sales service of the product.

~~34~~33. A jointly controlled entity maintains its own accounting records and prepares and presents financial statements in the same way as other entities in conformity with ~~the appropriate~~ International Public Sector ~~a~~Accounting ~~s~~Standards or other accounting standards if appropriate.

~~35~~34. Each venturer usually contributes cash or other resources to the jointly controlled entity. These contributions are included in the accounting records of the venturer and recognized in its ~~separate~~ financial statements as an investment in the jointly controlled entity.

~~Consolidated~~ Financial Statements of a Venturer

~~Benchmark Treatment —~~Proportionate Consolidation

~~36~~35. **~~In its consolidated financial statements, a~~ A venturer ~~should~~ shall ~~report~~ recognize its interest in a jointly controlled entity using proportionate consolidation or the alternative method described in paragraph 43. When proportionate consolidation is used, one of the two reporting formats ~~for proportionate consolidation~~ identified below shall be used.**

36. A venturer recognizes its interest in a jointly controlled entity using one of the two formats for proportionate consolidation irrespective of whether it also has investments in controlled entities or whether it describes its financial statements as consolidated financial statements.

37. When ~~reporting~~ recognizing an interest in a jointly controlled entity ~~in consolidated financial statements~~, it is essential that a venturer reflects the substance and economic reality of the arrangement, rather than the joint venture's particular structure or form. In a jointly controlled entity, a venturer has control over its share of future economic benefits or service potential through its share of the assets and liabilities of the venture. This substance and economic reality ~~is~~ are reflected in the consolidated financial statements of the venturer when the venturer ~~reports~~ recognizes its interests in the assets, liabilities, revenue and expenses of the jointly controlled entity by using one of the two reporting formats for proportionate consolidation described in paragraph 39.

38. The application of proportionate consolidation means that the ~~consolidated~~ statement of financial position of the venturer includes its share of the assets that it controls jointly and its share of the liabilities for which it is jointly responsible. The ~~consolidated~~ statement of financial performance of the venturer includes its share of the revenue and expenses of the jointly controlled entity. Many of the procedures appropriate for the application of proportionate consolidation are similar to the procedures for the consolidation of investments in controlled entities, which are set out in IPSAS 6.

39. Different reporting formats may be used to give effect to proportionate consolidation. The venturer may combine its share of each of the assets, liabilities, revenue and expenses of the jointly controlled entity with the

similar items, line by line, in its ~~consolidated~~ financial statements ~~on a line-by-line basis~~. For example, it may combine its share of the jointly controlled entity's inventory with ~~the~~ its inventory ~~of the economic entity~~ and its share of the jointly controlled entity's property, plant and equipment with ~~the same items of the economic entity~~ its property, plant and equipment. Alternatively, the venturer may include separate line items for its share of the assets, liabilities, revenue and expenses of the jointly controlled entity in its ~~consolidated~~ financial statements. For example, it may show its share of ~~the~~ a current asset~~s~~ of the jointly controlled entity separately as part of ~~the~~ its current assets ~~of the economic entity~~; it may show its share of the property, plant and equipment of the jointly controlled entity separately as part of ~~the~~ its property, plant and equipment ~~of the economic entity~~. Both these reporting formats result in the reporting of identical amounts of ~~net revenue and expenses~~ surplus or deficit and of each major classification of assets, liabilities, revenue and expenses; both formats are acceptable for the purposes of this Standard.

40. ~~Whatever~~Whichever format is used to give effect to proportionate consolidation, it is inappropriate to offset any assets or liabilities by the deduction of other liabilities or assets or any revenue or expenses by the deduction of other expenses or revenue, unless a legal right of set-off exists and the offsetting represents the expectation as to the realization of the asset or the settlement of the liability.

41. **A venturer ~~should~~ shall discontinue the use of proportionate consolidation from the date on which it ceases to have joint control over a jointly controlled entity.**

42. A venturer discontinues the use of proportionate consolidation from the date on which it ceases to share in the control of a jointly controlled entity. This may happen, for example, when the venturer disposes of its interest or when such external restrictions are placed on the jointly controlled entity ~~so~~ that ~~it can~~ the venturer no longer ~~achieve its goals~~ has joint control.

~~Allowed Alternative Treatment~~Equity Method

43. **~~In its consolidated financial statements~~As an alternative to proportionate consolidation described in paragraph 35, a venturer ~~should~~ shall ~~report~~ recognize its interest in a jointly controlled entity using the equity method.**

44. A venturer recognizes its interest in a jointly controlled entity using the equity method irrespective of whether it also has investments in controlled entities or

whether it describes its financial statements as consolidated financial statements.

~~44~~45. Some venturers ~~report~~ recognize their interests in jointly controlled entities using the equity method, as described in IPSAS 7. The use of the equity method is supported by those who argue that it is inappropriate to combine controlled items with jointly controlled items and by those who believe that venturers have significant influence, rather than joint control, in a jointly controlled entity. This Standard does not recommend the use of the equity method because proportionate consolidation better reflects the substance and economic reality of a venturer's interest in a jointly controlled entity, that is to say, control over the venturer's share of the future economic benefits or service potential. Nevertheless, this Standard permits the use of the equity method, as an ~~allowed~~ alternative treatment, when ~~reporting~~ recognizing interests in jointly controlled entities.

~~45~~46. **A venturer ~~should~~ shall discontinue the use of the equity method from the date on which it ceases to have joint control over, or have significant influence in, a jointly controlled entity.**

Exceptions to ~~Benchmark~~ Proportionate Consolidation and ~~Allowed Alternative Treatments~~ Equity Method

~~46~~47. ~~The following i~~Interests in jointly controlled entities for which there is evidence that the interest is acquired and held exclusively with a view to its disposal within twelve months from acquisition and that management is actively seeking a buyer, as set out in paragraph 3(a), ~~should~~ shall be ~~accounted~~ classified and accounted for as held for trading financial instruments in accordance with the relevant international or national accounting standard dealing with financial instruments.

~~for as investments:~~

~~(a)an interest in a jointly controlled entity which is acquired and held exclusively with a view to its subsequent disposal in the near future; and~~

~~(b)an interest in a jointly controlled entity which operates under severe long-term restrictions that significantly impair its ability to transfer funds or provide other non-financial benefits to the venturer.~~

~~47~~48. Guidance on recognition and measurement~~accounting for investments~~ of financial instruments dealt with in paragraph 47 can be found in the relevant international ~~and/~~or national accounting standard~~s~~ dealing with financial instruments.

49. When, in accordance with paragraphs 3(a) and 47, an interest in a jointly controlled entity previously accounted for as a held for trading financial instrument is not disposed of within twelve months, it shall be accounted for using proportionate consolidation or the equity method as from the date of acquisition. (Guidance on the meaning of the date of acquisition can be found in the relevant international or national accounting standard dealing with business combinations). Financial statements for the periods since acquisition shall be restated.

50. Exceptionally, a venturer may have found a buyer for an interest described in paragraphs 3(a) and 47, but may not have completed the sale within twelve months of acquisition because of the need for approval by regulators or others. The venturer is not required to apply proportionate consolidation or the equity method to an interest in a jointly controlled entity if the sale is in process at the reporting date and there is no reason to believe that it will not be completed shortly after the reporting date.

~~48. The use of either proportionate consolidation or the equity method is inappropriate when the interest in a jointly controlled entity is acquired and held exclusively with a view to its subsequent disposal in the near future. It is also inappropriate when the jointly controlled entity operates under severe long-term restrictions which significantly impair its ability to transfer funds or provide other non-financial benefits to the venturer.~~

~~49~~51. From the date on which a jointly controlled entity becomes a controlled entity of a venturer, the venturer shall account~~s~~ for its interest in accordance with IPSAS 6. From the date on which a jointly controlled entity becomes an associate of a venturer, the venturer shall account for its interest in accordance with IPSAS 7.

Separate Financial Statements of a Venturer

~~50. In some jurisdictions, separate financial statements may be presented by a venturer in order to meet legal or other requirements. Such separate financial statements are prepared in order to meet a variety of needs with the result that different reporting practices are in use in different jurisdictions. Accordingly, this Standard does not indicate a preference for any particular treatment.~~

52. **An interest in a jointly controlled entity shall be accounted for in a venturer's separate financial statements in accordance with paragraphs 58-64 of IPSAS 6.**

53. This Standard does not mandate which entities produce separate financial statements available for public use.

Transactions between a Venturer and a Joint Venture

~~51~~54. **When a venturer contributes or sells assets to a joint venture, recognition of any portion of a gain or loss from the transaction ~~should~~ shall reflect the substance of the transaction. While the assets are retained by the joint venture, and provided the venturer has transferred the significant risks and rewards of ownership, the venturer ~~should~~ shall recognize only that portion of the gain or loss ~~which~~ that is attributable to the interests of the other venturers. The venturer ~~should~~ shall recognize the full amount of any loss when the contribution or sale provides evidence of a reduction in the net realizable value of current assets or an impairment loss.**

~~52~~55. **When a venturer purchases assets from a joint venture, the venturer ~~should~~ shall not recognize its share of the gains of the joint venture from the transaction until it resells the assets to an independent party. A venturer ~~should~~ shall recognize its share of the losses resulting from these transactions in the same way as gains except that losses ~~should~~ shall be recognized immediately when they represent a reduction in the net realizable value of current assets or an impairment loss.**

~~53~~56. To assess whether a transaction between a venturer and a joint venture provides evidence of impairment of an asset, the venturer determines the recoverable amount or recoverable service amount of the assets in accordance with ~~the relevant guidance on impairment of assets~~ IPSAS 21, “Impairment of Non-Cash-Generating Assets”. In determining value in use of a cash-generating asset, the venturer estimates future cash flows from the asset ~~are estimated~~ on the basis~~ed on~~ of continuing use of the asset and its ultimate disposal by the joint venture. In determining value in use of a non-cash-generating asset, the venturer estimates the present value of the remaining service potential of the asset using the approaches specified in IPSAS 21.

Reporting Interests in Joint Ventures in the Financial Statements of an Investor

~~54~~57. **An investor in a joint venture~~, which~~ that does not have joint control, but does have significant influence ~~should~~ shall ~~report~~ account for its interest in a joint venture in accordance with IPSAS 7.**

~~55~~58. ~~**International Accounting Standard IAS 39, Financial Instruments: Recognition and Measurement provides g**~~**Guidance on accounting for interests in joint ventures where an investor does not have joint control or significant influence can be found in the relevant international or national accounting standard dealing with financial instruments.**

Operators of Joint Ventures

~~56~~59. **Operators or managers of a joint venture ~~should~~ shall account for any fees in accordance with ~~the appropriate standards that address accounting for~~ IPSAS 9 ~~r~~Revenue from ~~e~~Exchange ~~t~~Transactions.**

~~57~~60. One or more venturers may act as the operator or manager of a joint venture. Operators are usually paid a management fee for such duties. The fees are accounted for by the joint venture as an expense.

Disclosure

~~58~~61. **~~In accordance with the appropriate standards that address provisions, contingent liabilities and contingent assets, a~~ A venturer ~~should~~ shall disclose:**

~~(i)~~(a) **the aggregate amount of the following contingent liabilities, unless the possibility of any outflow in settlement is remote, separately from the amount of other contingent liabilities:**

~~(ii)~~(b) **any contingent liabilities that the venturer has incurred in relation to its interests in joint ventures and its share in each of the contingent liabilities ~~which~~ that have been incurred jointly with other venturers;**

~~(iii)~~(c) **its share of the contingent liabilities of the joint ventures themselves for which it is contingently liable; and**

~~(b)~~(d) **those contingent liabilities that arise because the venturer is contingently liable for the liabilities of the other venturers of a joint venture; and**

(e) **a brief description of the following contingent assets and, where practicable, an estimate of their financial effect, where an inflow of economic benefits or service potential is probable:**

(i) **any contingent assets of the venturer arising in relation to its interests in joint ventures and its share in each of the contingent assets ~~which~~ that have arisen jointly with other venturers; and**

(ii) **its share of the contingent assets of the joint ventures themselves.**

~~59~~62. **A venturer ~~should~~ shall disclose the aggregate amount of the following commitments~~,~~ in respect of its interests in joint ventures~~,~~ separately from other commitments:**

(a) **any capital commitments of the venturer in relation to its interests in joint ventures and its share in the capital commitments that have been incurred jointly with other venturers; and**

(b) **its share of the capital commitments of the joint ventures themselves.**

~~60~~63. **A venturer ~~should~~ shall disclose a listing and description of interests in significant joint ventures and the proportion of ownership interest held in jointly controlled entities. A venturer ~~which reports~~ that recognizes its interests in jointly controlled entities using the line-by-line reporting format for proportionate consolidation or the equity method ~~should~~ shall disclose the aggregate amounts of each of current assets, non-current assets, current liabilities, non-current liabilities, revenue and expenses related to its interest in joint ventures.**

64. **A venturer shall disclose the method it uses to recognize its interests in jointly controlled entities.**

~~**61. A venturer which does not issue consolidated financial statements because it does not have controlled entities, should disclose the information required in paragraphs 58, 59, and 60 (where applicable).**~~

~~62.It is appropriate that a venturer which does not prepare consolidated financial statements because it does not have controlled entities provides the same information about its interests in joint ventures as those venturers that issue consolidated financial statements.~~

Transitional Provisions

~~63~~65. **Where the ~~benchmark treatment~~ proportionate consolidation treatment set out in this Standard is adopted, ~~entities~~ venturers are not required to eliminate balances and transactions between themselves, their controlled entities and entities that they jointly control for reporting periods beginning on a date within three years following the date of first adoption of ~~this Standard~~ accrual accounting in accordance with International Public Sector Accounting Standards.**

~~64~~66. Entities that adopt ~~this Standard~~ accrual accounting for the first time in accordance with International Public Sector Accounting Standards may have many controlled and jointly controlled entities with a significant number of transactions between these entities. Accordingly, it may initially be difficult to identify all the transactions and balances that need to be eliminated for the purpose of preparing the financial statements. For this reason, paragraph ~~63~~65 provides temporary relief from eliminating in full balances and transactions between entities and their jointly controlled entities.

~~65~~67. **Where entities apply the transitional provision in paragraph ~~63~~65, ~~an entity~~ they ~~should~~ shall disclose the fact that not all inter-entity balances and transactions have been eliminated.**

68. Transitional provisions in IPSAS 8 (2000) provide entities with a period of up to three years to fully eliminate balances and transactions between entities within the economic entity from the date of its first application. Entities that have previously applied IPSAS 8 (2000) may continue to take advantage of this three-year transitional provisional period from the date of first application of IPSAS 8 (2000).

Effective Date

~~6~~69. **An entity shall apply ~~T~~this International Public Sector Accounting Standard ~~becomes effective~~ for annual financial statements covering periods beginning on or after ~~1 July 2001~~ MM DD YYYY. Earlier application is encouraged. If an entity applies this Standard for a period beginning before MM DD YYYY, it shall disclose that fact.**

~~6~~70. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, 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 8 (2001)

71. This Standard supersedes IPSAS 8, "Financial Reporting of Interests in Joint Ventures" issued in 2001.

Appendix

Amendments to Other IPSASs

The amendments in this appendix shall be applied for annual financial statements covering periods beginning on or after MM DD YYYY. If an entity applies this Standard for an earlier period, these amendments shall be applied for that earlier period.

A1. In International Public Sector Accounting Standards applicable at MM YYYY, references to the current version of IPSAS 8, "Financial Reporting of Interests in Joint Ventures" are amended to IPSAS 8, "Interests in Joint Ventures".

Comparison with IAS 31

International Public Sector Accounting Standard IPSAS 8~~ *Financial Reporting of*~~ *Interests in Joint Ventures* is drawn primarily from International Accounting Standard IAS 31,~~ *Financial Reporting of*~~ *Interests in Joint Ventures*. At the time of issuing this Standard, the IPSASB has not considered the applicability of IFRS 3, "Business Combinations" and IFRS 5, "Non-current Assets Held for Sale and Discontinued Operations", to public sector entities. Therefore, IPSAS 8 does not reflect amendments made to IAS 31 consequent on the issue of IFRS 3 and IFRS 5.The main differences between IPSAS 8 and IAS 31 are as follows:

- Commentary additional to that in IAS 31 has been included in IPSAS 8 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 8 uses different terminology, in certain instances, from IAS 31. The most significant examples are the use of the terms ~~"entity",~~ "revenue", "statement of financial performance", "statement of financial position" and "net assets/equity" in IPSAS 8. The equivalent terms in IAS 31 are~~ "enterprise",~~ "income", "income statement", "balance sheet" and "equity".
- ~~IPSAS 8 contains a different set of definitions of technical terms from IAS 31 (paragraph 5).~~
- IPSAS 8 uses a different definition of joint venture from IAS 31. The term "contractual arrangement" has been replaced by "binding arrangement".
- IPSAS 8 includes a transitional provision that permits entities which adopt~~ the benchmark treatment~~ proportionate consolidation treatment to not eliminate all balances and transactions between~~ entities~~ venturers, their controlled entities and entities that they jointly control~~ within the economic entity~~ for reporting periods beginning on a date within three years following the date of~~ first application of this Standard~~ adopting accrual accounting for the first time in accordance with International Public Sector Accounting Standards. IAS 31 does not contain transitional provisions.