



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

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Agenda Item

8

Date: May 24, 2012
Memo to: Members of the IPSASB
From: Joanne Scott
Subject: Update of IPSASs 6-8

Objectives of this Session

1. The objectives of this session are to:
 - (a) summarize the requirements of new and revised IFRSs;
 - (b) confirm the approach to be taken in revising IPSASs, including application of the Rules of the Road;
 - (c) confirm that certain issues should be considered as part of the project;
 - (d) identify possible useful sources of information for the project; and
 - (e) agree the proposed timeline.

Agenda Material

2. Agenda material attached to this memorandum:
 - 8.1 Project plan (as at September 2011)
 - 8.2 Rules of the Road: Process for Reviewing and Modifying IASB documents (October 2008)
 - 8.3 Draft implementation guidance developed by the Australian Accounting Standards Board (AASB) for not-for-profit entities applying AASB 10 *Consolidated Financial Statements* (draft as at April 2012)

Background

3. The IPSASB has previously considered a project plan in June 2011 and September 2011 (refer agenda item 8.1). The objective of the project is to revise IPSASs 6–8 and issue a separate IPSAS on consolidated financial statements and a new IPSAS on disclosure of interests in other entities. Possible changes to this project plan are discussed in this memo.

4. The project plan proposes that the IPSASB develop an IPSAS version of the IASB standards. The following issues have been identified in the IPSASB project brief.
 - (a) Should the temporary control exemption from consolidation in IPSAS 6 be retained?
 - (b) Should the scope of the project include consideration of whether the term control should continue to be used and whether the revised definition of control is appropriate?
 - (c) Should the scope of the project include consideration of whether all controlled entities should be consolidated?
 - (d) How should the project address the consolidation of structured entities?
5. The IPSASB has established a Task Based Group (TGB) to oversee and assist with this project. Members of the IPSASB TBG are:
 - (a) Adriana Tiron Tudor, Professor, Babes-Bolyai University, Romania;
 - (b) Ken Warren, Chief Accounting Advisor, The Treasury, New Zealand;
 - (c) Masud Muzaffar, Controller General of Accounts, Government of Pakistan; and
 - (d) Stefan Berger, Federal Department of Finance, Switzerland.
6. Following feedback from the Board on the issues raised in this memo staff will liaise with the TBG to plan future work.

New and revised IFRSs

7. The IASB's consolidation project has been split into two parts. The main objective of the project was to revise the definition of control and to enhance related disclosures. This part has been completed. The second part deals with the topic of investment entities and whether they should be excluded from the consolidation requirements. This second part is still under consideration.
8. The relationship between IPSASs 6-8 and the new and revised IFRSs, and some of the matters considered during the development of the IFRSs, are set out below.

IPSASs	IFRSs
IPSAS 6 <i>Consolidated and Separate Financial Statements</i> (based on IAS 27 (revised 2003))	IFRS 10 <i>Consolidated Financial Statements</i> IAS 27 <i>Separate Financial Statements</i> (2011)
IPSAS 7 <i>Investments in Associates</i> (based on IAS 28 (revised 2003) ¹)	IAS 28 <i>Investments in Associates and Joint Ventures</i> (2011)
IPSAS 8 <i>Investments in Joint Ventures</i>	IFRS 11 <i>Joint Arrangements</i>

¹ Amended by 2008 Improvements.

² The investment entities project is a joint effort between the Financial Accounting Standards Board (FASB) and the IASB to develop converged criteria for determining whether an entity is an investment entity. The FASB issued a separate ED in October 2011 which contained slightly different proposals.

³ A sovereign wealth fund is a state-owned investment fund or entity that is commonly established from balance of payments and/or receipts resulting from resource exports. The definition of sovereign wealth fund excludes, among other things, foreign

IPSASs	IFRSs
(based on IAS 31 (revised 2003) ¹)	
	IFRS 12 <i>Disclosure of Interests in Other Entities</i>

IFRS 10

9. IFRS 10 establishes principles for the preparation of consolidated financial statements when an entity controls one or more other entities. The Standard:
 - (a) defines control of an investee;
 - (b) establishes control as the basis for determining which entities are consolidated in the consolidated financial statements; and
 - (c) sets out the requirements for the preparation of consolidated financial statements.
10. In order to have control over an investee, the investor must have the following three elements:
 - (a) power over the investee;
 - (b) exposure, or rights, to variable returns from its involvement with the investee; and
 - (c) the ability to use its power over the investee to affect the amount of the investor's returns. For the purpose of assessing power, IFRS 10 distinguishes between substantive rights and protective rights. For a right to be substantive, the holder must have the practical ability to exercise that right. Protective rights are not considered when assessing power.
11. Relevant definitions from IFRS 10 are shown below.

control of an investee	An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.
power	Existing rights that give the current ability to direct the relevant activities.
protective rights	Rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate.
relevant activities	For the purpose of this IFRS, relevant activities are activities of the investee that significantly affect the investee's returns.
12. An investor reassesses whether it controls an investee if facts and circumstances indicate that there have been changes to one or more of the three elements of control.
13. IFRS 10 provides application guidance on assessing control in various circumstances. Issues covered in the application guidance include:
 - (a) voting rights or similar rights give an investor power, including situations where an investor holds less than a majority of voting rights or potential voting rights;
 - (b) voting rights are not the dominant factor in deciding who controls the investee;

- (c) agency relationships;
 - (d) whether the investor has control over specified assets of an investee; and
 - (e) determining whether rights are substantive.
14. The requirements in IAS 27 (2008) regarding consolidation procedures and the accounting requirements for the loss of control over an entity were carried over into IFRS 10.
15. IFRS 10 does not specify disclosure requirements. The IASB decided to locate the disclosure requirements for interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities in a single standard, IFRS 12 *Disclosure of Interests in Other Entities*.

IAS 27 *Separate Financial Statements* (as amended in 2011)

16. IAS 27 *Consolidated and Separate Financial Statements* (2008) was superseded by IAS 27 *Separate Financial Statements* (as amended in 2011) and IFRS 10.
17. IAS 27 (as amended in 2011) requires an entity that elects to prepare separate financial statements to account for investments in subsidiaries, associates and joint ventures at (i) cost or (ii) in accordance with IFRS 9 *Financial Instruments*.

IFRS 11 *Joint Arrangements*

18. IFRS 11 *Joint Arrangements* superseded IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities—Non-Monetary Contributions by Venturers*. It also amended IAS 28.
19. Under IAS 31:
- (a) the structure of the joint arrangement was the only determinant of the accounting requirements; and
 - (b) an entity had a choice of accounting treatment for interests in jointly controlled entities.
20. IFRS 11 requires a party to a joint arrangement to determine the type of joint arrangement in which it is involved by assessing its rights and obligations arising from the arrangement. IFRS 11 specifies accounting requirements for two types of joint arrangements:
- (a) a **joint operation** – the parties that have joint control over the arrangement have rights to the assets and obligations for the liabilities relating to the arrangement. A party with joint control over a joint operation is required to recognize and measure the assets and liabilities and recognize the related revenues and expenses arising from its interest in the arrangement in accordance with the relevant IFRSs applicable to their nature; and
 - (b) a **joint venture** – the parties that have joint control over the arrangement have rights to the net assets of the arrangement. A party with joint control over a joint venture is required to recognize an investment in that joint venture and account for it using the equity method in accordance with IAS 28. This means that proportionate consolidation may no longer be used to account for an investment in a joint venture.

21. The IASB has removed proportionate consolidation as it is defined in IFRSs. However, it is not preventing a party to a joint arrangement from recognizing individual assets and liabilities and the related revenue and expenses when that party has rights to them.
22. In the majority of cases, accounting for assets and liabilities gives the same outcome as proportionate consolidation would have done. There are two main differences:
 - (a) The proportion of a joint operation's assets etc which are recognized by the investor is based on the contractual arrangement rather than the ownership interest; and
 - (b) the parties' interests in a joint operation are recognized in their *separate* financial statements (and consequently in their consolidated financial statements). Previously proportionate consolidation occurred only in the consolidated financial statements.

IAS 28 *Investments in Associates and Joint Ventures* (as amended in 2011)

23. As a consequence of the changes to accounting for joint ventures in IFRS 11, IAS 28 (as amended in 2011) now requires an entity with joint control of, or significant influence over, an investee to account for its investment in an associate or a joint venture using the equity method. In revising IAS 28, the IASB did not reconsider the use of the equity method.

IFRS 12 *Disclosure of Interests in Other Entities*

24. The objective of IFRS 12 is to require an entity to disclose information that enables users of its financial statements to evaluate (a) the nature of, and risks associated with, its interest in other entities; and (b) the effects of those interests on its financial position, financial performance and cash flows. An entity is required to comply with the disclosures in IFRS 12 in respect of its interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities.

IASB project on investment entities

25. As part of its consolidation project, the IASB is also examining how an investment entity accounts for its interests in subsidiaries, joint ventures and associates and what, if any, disclosures might be made about those interests. The IASB published an exposure draft on investment entities in August 2011². This ED proposed that an investment entity (as defined) should not consolidate investments in entities that it controls – that is investment entities would fall outside the scope of IFRS 10. Instead it proposed that an investment entity should measure those investments at fair value, with changes in fair value recognized in profit or loss. The ED proposed that an investment entity would measure controlled investees at fair value, regardless of whether that controlled investee is an operating entity or an investment entity (with the exception of consolidating an operating entity that provides services to the investment entity). The ED, however, required that a non-investment parent of a controlled investment entity should consolidate the subsidiaries of that investment entity.

² The investment entities project is a joint effort between the Financial Accounting Standards Board (FASB) and the IASB to develop converged criteria for determining whether an entity is an investment entity. The FASB issued a separate ED in October 2011 which contained slightly different proposals.

26. Comments on this ED were due in January 2012. The IASB received 170 comment letters and has also held a number of round-table discussions earlier this year. The IASB and FASB have commenced their deliberations on comments received. IASB board papers (April 2012) stated that the majority of constituents were supportive of the IASB ED's proposal to provide an exception from consolidation for investment entities.
27. Reasons given by those supporting the proposals were as follows:
- (a) Investment entities manage all of their investments on a fair value basis and use fair value information to evaluate their performance. Requiring consolidation of an investment entity's controlled investments would not reflect the way in which those investments are managed.
 - (b) Fair value information is the most relevant and useful information for the investors of investment entities. Investors in investment entities focus on the fair value of an investment entity when assessing the performance of that entity and making their buy/hold/sell decisions. Requiring consolidation of controlled investees would obscure the financial statements of an investment entity and would not result in the most relevant and useful information for investors.
 - (c) US GAAP and other local GAAPs have historically contained specialized accounting guidance for entities similar to investment entities, including an exception from consolidating controlled operating entities. This guidance has worked well in these jurisdictions.
 - (d) Current IFRS guidance has negatively influenced business practice, with investment entities deliberately avoiding majority holdings or noninvestment entity parents selling off investment entity subsidiaries in order to avoid consolidation requirements.
 - (e) The clarification of the concept of control in IFRS 10 makes it even more important that an exception from consolidation is introduced for investment entities. Without an exception, many investment entities will have to consolidate minority holdings where they have de facto control.
 - (f) Consolidating controlled investees would involve significant time, cost and complexity for preparers of investment entity financial statements, with limited (if any) perceived benefits.
 - (g) Control is an important conceptual principle but should not override all other considerations in setting accounting standards, especially when fair value information may provide more relevant information.
28. Despite the fact that a majority of respondents supported the proposals, the proposals have been controversial and there has been strong opposition from some quarters. Arguments by those opposing the proposals include the following:
- (a) The principle of consolidating controlled investees is 'fundamental to the preparation and presentation of financial statements' and an exception to that principle would deprive financial statement users of information about the activities of controlled investees and the economic effects of the relationships between an investment entity and its controlled investees. This is the alternative view set out in the ED.
 - (b) The arguments for giving an investment entity an exception from consolidation are not strong enough. These constituents argued that the proposals lack a strong conceptual basis and are too rules-based.

- (c) The proposals would introduce industry-specific guidance into IFRSs. These constituents felt that the introduction of a rules-based, industry-specific exception would encourage abuse and structuring to avoid consolidation.
29. Even amongst those who support the proposals in the ED there are concerns about the proposed approach to identifying investment entities and the criteria for identifying investment entities. The ED proposed an entity approach to identifying investment entities, with the accounting treatment being based on the type of entity that owns the investment/asset. Some respondents suggested that an asset-approach should be used. Under an asset-based approach, an entity would focus on the specific characteristics of the investment (that is, an individual asset) to determine if fair value measurement is more appropriate.
30. The IASB and FASB are continuing to consider feedback from constituents. At their May 2012 meeting they reconsidered the criteria for the identification of investment entities, including whether all criteria must be met for an entity to meet the definition of an investment entity. Tentative decisions by the IASB at that meeting are shown below.

The definition of an investment entity would be as follows:

1. An investment entity does all of the following:
 - (a) obtains funds from an investor or investors and provides the investor(s) with professional investment management services;
 - (b) commits to its investor(s) that its business purpose and only substantive activities are investing the funds for returns from capital appreciation or capital appreciation and investment income; and
 - (c) manages and evaluates the performance of substantially all of its investments on a fair value basis.
2. An investment entity and its affiliates do not obtain, or have the objective of obtaining, returns or benefits from their investments that are either of the following:
 - (a) other than capital appreciation or capital appreciation and investment income; and
 - (b) not available to other non investors or are not normally attributable to ownership interests.

The IASB tentatively decided that an entity that has more than an insignificant amount of investments that are not managed on a fair value basis or held for investment income only would not be an investment company.

31. This discussion of the IASB's project on investment entities has been included in this memo because those who consider that there should be more exceptions from the requirement to consolidate controlled entities might support these proposals. For example, some might argue that the proposals would be appropriate in relation to a government's treatment of its sovereign wealth funds.³ Consideration of the IASB's proposals in relation to investment entities would result in a more comprehensive project. However, it is uncertain when the IASB will issue a final standard on

³ A sovereign wealth fund is a state-owned investment fund or entity that is commonly established from balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, governmental transfer payments, fiscal surpluses, and/or receipts resulting from resource exports. The definition of sovereign wealth fund excludes, among other things, foreign currency reserve assets held by monetary authorities for the traditional balance of payments or monetary policy purposes, state-owned enterprises (SOEs) in the traditional sense, government-employee pension funds (funded by employee/employer contributions), or assets managed for the benefit of individuals.

this topic. Key issues are still being debated and there continues to be strong opposition from some quarters. There is a risk that revising the IPSASB's project plan to include consideration of this topic could delay completion of the IPSASB project.

32. Options available to the IPSASB in relation to the IASB's project on investment entities include:
- (a) agree to develop a separate IPSAS on investment entities and revise the current project plan to reflect this change; or
 - (b) monitor the IASB's project, but do not modify the project plan on revising IPSASs 6-8.
33. Staff support option (b) on the grounds that the IASB is still debating key issues, the issues are complex and incorporating this topic within the IPSASB's project to revise IPSAS 6-8 could delay that project.

Action Requested:

Does the Board agree with option (b): that is, to monitor the IASB's project on investment entities, but not to modify the IPSASB's current project plan?

Summary of recognition and measurement requirements

34. The key recognition and measurement requirements in IPSASs 6-8 and the relevant IFRSs are set out below. Differences in identifying controlled entities are discussed separately.

IPSASs	IFRSs
<p>IPSAS 6 <i>Consolidated and Separate Financial Statements</i></p> <p><u>In separate financial statements</u></p> <p>Account for investments in controlled entities, jointly controlled entities and associates</p> <ul style="list-style-type: none"> • using the equity method (per IPSAS 7) • at cost, or • as a financial instrument in accordance with IPSAS 29 (likely to be at fair value through surplus or deficit) 	<p>IAS 27 <i>Separate Financial Statements</i> (as amended in 2011)</p> <p>Account for investments in subsidiaries, joint ventures and associates (including investments held for sale) either</p> <ul style="list-style-type: none"> • at cost, or • in accordance with IFRS 9 <i>Financial Instruments</i> (fair value) <p>Where investments held for sale are measured at cost, cost is measured in accordance with IFRS 5 <i>Non-current Assets Held for Sale and Discontinued Operations</i></p> <p>The accounting requirements in separate financial statements for joint operations and joint ventures where the entity does NOT have joint control are set out in IFRS 11.</p>

IPSASs	IFRSs
<p>IPSAS 6 <i>Consolidated and Separate Financial Statements</i></p> <p><u>In group financial statements</u></p> <p>Consolidate controlled entities (some scope exclusions, including temporary control)</p> <p>If temporary control, account for as per IPSASs 28-30</p> <p>IPSAS 6 contains no guidance on special purpose entities (such entities were previously discussed in SIC-12).</p>	<p>IFRS 10 <i>Consolidated Financial Statements</i></p> <p>Consolidate controlled entities (some scope exclusions)</p> <p>If a subsidiary is classified as held for sale, the subsidiary is still consolidated, but the assets and liabilities of that subsidiary are classified as held for sale in accordance with IFRS 5 (refer IFRS 5 paragraph 8A)</p> <p>The guidance in IFRS 10 is to be applied to all entities, including “structured entities”.</p>
<p>IPSAS 7 <i>Investments in Associates</i></p> <p>Account for investments in associates using the equity method (some exclusions)</p> <p>If temporary control, classify as “held for trading” and measure as per IPSAS 29</p>	<p>IAS 28 <i>Investments in Associates and Joint Ventures</i> (as amended in 2011)</p> <p>An entity with joint control of, or significant influence over, an investee shall account for its investment in an associate or a joint venture using the equity method</p> <p>Account for investments classified as held for sale in accordance with IFRS 5</p> <p>IAS 28 includes the requirements for the accounting for transactions entered into between a joint venturer and a joint venture, including the consensus of SIC-13 <i>Jointly Controlled Entities—Non-Monetary Contributions by Venturers</i></p>
<p>IPSAS 8 <i>Interests in Joint Ventures</i></p> <p>In GROUP financial statements, account for jointly controlled:</p> <ul style="list-style-type: none"> • <u>operations</u> by recognizing the assets, liabilities etc (these may not be separate entities) • <u>assets</u> by recognizing the entity’s share of jointly controlled assets, liabilities etc (these may not be separate entities) • <u>entities</u> using proportionate consolidation or the equity method (<i>group accounts only</i>). 	<p>IFRS 11 <i>Joint Arrangements</i></p> <p>In GROUP financial statements, account for:</p> <p><u>Joint operations</u></p> <p>(including jointly controlled operations and assets)</p> <ul style="list-style-type: none"> • joint operations (with joint control or with “rights and obligations”) by recognizing the entity’s share of items (eg assets and liabilities) using the relevant IFRSs • other joint operations using relevant IFRSs (eg IFRS 9, IFRS 5, possibly IAS 28) <p><u>Joint ventures</u></p>

IPSASs	IFRSs
<p>In SEPARATE financial statements account for <u>Jointly controlled operations and assets</u> in the same way as in the group statements (see above)</p> <p><u>Jointly controlled entities</u></p> <ul style="list-style-type: none"> • using the equity method • at cost or • as a financial instrument <p>If temporary control, classify as “held for trading” and measure as per IPSAS 29.</p>	<ul style="list-style-type: none"> • joint ventures (with joint control) using the equity method in accordance with IAS 28 • joint ventures (with significant influence) using the equity method in accordance with IAS 28 • other joint ventures in accordance with IFRS 9 <p>In SEPARATE financial statements account for <u>Joint operations and Joint ventures</u> in the same way as in the group statements (see above)</p> <p>IFRS 5 establishes measurement requirements for assets held for sale</p>

Action Requested:

Note the key accounting treatment differences between IPSASs 6-8 and IFRSs.

Terms of Reference and Rules of the Road

35. The IPSASB’s approach to developing IPSASs is guided by its Terms of Reference and the Rules of the Road. An extract from the IPSAB’s Terms of Reference (revised, November 2011) is set out below.

Extract from IPSASB’s Terms of Reference

8.0 DUE PROCESS

....

In developing its pronouncements, the IPSASB seeks input from its consultative group and considers and makes use of pronouncements issued by:

- The International Accounting Standards Board (IASB) to the extent they are applicable to the public sector;
- National standard setters, regulatory authorities and other authoritative bodies
- Professional accounting bodies; and
- Other organizations interested in financial reporting in the public sector.

The IPSASB will ensure that its pronouncements are consistent with those of IASB to the extent those pronouncements are applicable and appropriate to the public sector.

36. The IPSASB has developed a process for developing standards based on IFRSs, referred to as the “Rules of the Road” (refer agenda item 8.2). It requires that a consistent process be applied in determining whether IPSASs are to be based on IFRSs and, if so, which aspects of the IFRSs need to be amended for application by public sector entities.
37. The Rules of the Road were initially developed in 2007 and have been used with minor revisions since. The process must be applied by staff when developing proposals for the Board, but it is not binding on Board members. In accordance with the project brief, the Rules of the Road will be applied when considering amendments to the IFRSs.
38. There are four steps in the process:
- (a) Step 1: Are there public sector issues that warrant departure? If sufficient concerns are identified as part of Step 1 this might warrant a departure from the IASB requirements.
 - (b) Step 2: Should a separate public sector project be initiated? If the public sector issues can be addressed within a document that is converged with the related IASB document, the IPSASB moves to Step 3. If the public sector issues do not warrant a departure from the IASB requirements, the IPSASB goes straight to Step 4.
 - (c) Step 3: Modify IASB documents.
 - (d) Step 4: Make IPSASB style and terminology changes to IASB documents.
39. Step 1 of the process requires that the IPSASB consider whether applying the IASB requirements would give rise to concerns about:
- (a) meeting the objectives of financial reporting;
 - (b) meeting the qualitative characteristics; or
 - (c) undue cost or effort.
40. The Rules of the Road state that “All decisions will be made in the context of considering:
- (a) consistency with the IPSASB *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*, as it develops;⁴
 - (b) internal consistency with existing IPSASs; and
 - (c) consistency with the statistical bases.”
41. This memo identifies issues that may warrant departures from IFRSs (including differing requirements or providing additional guidance). This is the first time that the Rules of the Road have been applied to these standards. As the project progresses and the Board consider issues in more detail it is likely that the Board will identify further issues.
42. In identifying issues that might warrant departures from the relevant IFRSs, staff have considered:
- (a) **The public sector modifications in IPSASs 6-8.** Although IPSASs 6-8 were developed prior to the Rules of the Road, it is likely that many of the modifications made in developing these standards would be supported by the Rules of the Road. It is proposed that the modifications in IPSASs 6-8 be used as the starting point for identifying possible departures

⁴ Refer to Appendix A for a summary of related decisions made in Phase 1 of the conceptual framework project.

from IFRSs. Any proposed modifications will need to be supported by a Rules of the Road analysis and would need to be considered in the context of the current IFRSs.

- (b) **Other public sector guidance:** The decisions of other standard setters or guidance developed by other standards setters is likely to be useful when considering proposed modifications. Some examples of other guidance or actions taken by other standard setters are presented in this memo; and
- (c) **Statistical reporting requirements:** differences that have been identified between financial reporting and statistical reporting requirements.

Purpose of the public sector modifications in IPSASs 6-8

- 43. This section identifies the key public sector modifications made when developing IPSASs 6-8 and the context within which the Rules of the Road will be applied to these issues in the current project.

IPSAS 6 modifications	Implications for current project
<u>Terminology changed in IPSAS 6</u> economic entity (group) controlling entity (parent) controlled entity (subsidiary) minority interest (now referred to in IFRSs as non-controlling interest) ⁵ <u>Terminology not changed in IPSAS 6</u> investee – already in IPSASs 1,6,7,10,22 investor– already in IPSAS 7	Review terminology – is there still support for the terminology used in IPSASs 6-8? Consider appropriateness of new terms in IFRS 10: control of an investee decision maker power protective rights relevant activities removal rights returns
<u>Scope</u> The exemption from presenting consolidated financial statements for controlling entities which are themselves wholly owned (para 16(a)(i)) is broader than the exemption in IAS 27	Reconsider exemptions from the requirement to present consolidated financial statements

⁵ The term 'non-controlling interest' reflects the fact that a controlling entity is able to control a controlled entity with less than 50% of the voting rights; ie a minority interest may be a controlling interest.

IPSAS 6 modifications	Implications for current project
<p><u>Control</u></p> <p>Defined as: The power to govern the financial and operating policies of another entity so as to benefit from its activities. (IPSAS 2 para 8)</p> <p>IPSAS 6 contains additional guidance on whether control exists in a public sector context (paras 28-41)</p> <p>Key ideas include:</p> <ul style="list-style-type: none"> Power element (conditions and indicators) Benefit element (conditions and indicators) Power must be presently exercisable (but not necessarily exercised) Power giving rise to control may be conferred by legislation Entities may have separate legislative powers but still be controlled Regulatory and purchase powers do not constitute control Benefits may be financial or non-financial 	<p><u>Control of an investee</u></p> <p>Defined as: An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.</p> <p>There are three key elements of control:</p> <ul style="list-style-type: none"> Power over an investee (whether or not that power is used in practice); Exposure, or rights, to variable returns from an investee; and The ability to use the power over an investee to affect the reporting entity's returns from that investee <p>Consider how to incorporate the ideas underlying the additional guidance in IPSAS 6</p> <p>Consider the outcome of applying the requirements in IFRS 10 to various public sector examples</p>
<p><u>Presentation</u></p> <p>Requires losses applicable to the minority interest that exceed the minority interest in the controlled entity to be allocated against the majority interest, <i>except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses</i> (para 56)</p>	<p>Reconsider treatment of losses applicable to the minority interest</p>
<p><u>Separate financial statements</u></p> <p>Permits the use of the equity method to account for controlled entities in the separate financial statements of controlling entities</p>	<p>The equity method is not permitted in IAS 27 (as amended in 2011)</p> <p>Consider whether there are any grounds to warrant departure from the IFRS treatment</p>
<p><u>Disclosure</u></p> <p>Requires disclosure of significant controlled entities (para 62(a))</p>	<p>IFRS 12 <i>Disclosure of Interests in Other Entities</i> does not specifically require a list of significant controlled entities but, amongst other things, it requires disclosure of the</p>

IPSAS 6 modifications	Implications for current project
<p>Requires disclosure of non-consolidated controlled entities where control is intended to be temporary and management is actively seeking a buyer (para 62(b))</p> <p>Requires disclosure of 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 (para 62(c))</p>	<p>composition of the group and significant non-controlling interests (para 10)</p> <p>All of the disclosures in IFRS 12 will need to be considered for relevance to the public sector</p> <p>Consider appropriateness of IFRS 12 disclosures</p> <p>Consider appropriateness of IFRS 12 disclosures</p>
<p><u>Illustrative examples</u></p> <p>IPSAS 6 includes five additional examples:</p> <ul style="list-style-type: none"> • Right to Purchase at Premium to Fair Value (IE4-IE5) • Possibility of exercise of rights (IE7-IE8) • Other rights that have the potential to increase an entity's voting power or reduce another entity's voting power – Example B (IE11-IE12) • Management Intention – Example B (IE14) • Financial Ability – Example B (IE17-IE18) 	<p>Consider which of the examples in IPSAS 6 should be retained and revise them in the context of IFRS 10</p> <p>Consider whether IFRS 10 examples are appropriate</p> <p>Consider whether new examples are required</p>
<p><u>No guidance in IPSAS 6</u></p> <p>IPSAS 6 does not include guidance on:</p> <ul style="list-style-type: none"> • Special purpose entities • Establishment of a new parent entity • Loss of control 	<p>Consider whether requirements in IFRS 10 and IAS 27 on these topics are appropriate in the public sector context</p>
<p><u>Transitional provision</u></p> <p>Permits entities to not eliminate inter-entity transactions and balances for 3 years</p>	<p>Reconsider concessions on first-time adoption in the context of the first-adoption standard</p> <p>Consider whether transitional provisions in IFRS 10 are appropriate for entities that have previously applied IPSAS 6⁶</p>

⁶ The IASB has recently proposed a clarification of the transitional provisions in IFRS 10.

IPSAS 7 modifications	Implications for current project
<p><u>Scope</u></p> <p>The standard applies to all investments in associates where the investor holds an ownership interest in the form of a shareholding or other formal equity structure</p> <p>The exemption from applying the equity method (para 19(c)(i)) is broader than the exemption in IAS 28</p>	<p>Consider whether to carry forward this scope limitation</p> <p>Reconsider exemption from applying the equity method</p>

IPSAS 8 modifications	Implications for current project
<p><u>Definitions</u></p> <p>Defines joint venture and joint control in terms of binding arrangements (paras 6 to 10)</p>	<p>IFRS 11 defines joint arrangements in terms of contractual arrangements. Modification will be required</p>
<p><u>Disclosure</u></p> <p>Requires a brief description and, where practicable, an estimate of the financial effect of contingent assets relating to an interest in a joint venture or the joint venture itself to be disclosed, if an inflow of economic benefits or service potential is probable (para 61(b))</p>	<p>Consider all IFRS 12 disclosure requirements</p>

44. It is proposed that the public sector specific modifications in IPSASs 6-8 be used as the starting point for identifying possible departures from IFRSs. As noted above, proposed modifications to IFRSs will need to be supported by a Rules of the Road analysis. The right hand column in the above tables gives a “big picture” outline of the work that will need to be done. Any feedback the Board can give to guide this future work would be welcome.
45. Key issues are likely to include:
- (a) deciding whether to modify the definition of control of an investee. The definition of control of an investee in IFRS 10 uses the term “returns” which is likely to require additional explanation in a public sector context;
 - (b) giving appropriate balance to the discussion of non-financial returns. Although IFRS 10 includes some discussion of non-financial returns it has a strong focus on financial returns;

- (c) considering what the concepts of substantive rights and protective rights would mean in the public sector and whether application of these concepts would be appropriate;
 - (d) developing public sector specific examples, especially in relation to (i) non-financial benefits; (ii) complementary benefits; (iii) entities that are established on autopilot; and (iv) entities that have varying types of statutory independence. Staff would welcome thoughts on issues that should be covered in the examples;
 - (e) reconsidering exemptions from the scope or requirements of the standards (the temporary control exemptions are discussed later in this memo). Are the IASB's proposals on investment entities likely to be appropriate for the public sector?;
 - (f) considering whether all the disclosures in IFRS 12 are appropriate in the public sector context, and, whether any additional disclosures should be considered.
46. At this point it is anticipated that there will be a number of departures from the requirements of IFRSs. An important part of the project will be documenting the Board's reasons for making these departures, and where appropriate, documenting other options considered by the Board. This justification of modifications is important to (i) demonstrate due process; (ii) provide a record of the Board's reasoning and (iii) help entities applying the requirements to use uniform accounting policies in consolidated financial statements to identify which accounting policies of controlled entities require adjustment (this issue is discussed in the next section).

Other issues for the IPSASB to consider

Use of 'returns' rather than 'benefits'

47. The definition of control in IFRS 10 refers to the generation of 'returns for the reporting entity'. During consultation on the proposals in IFRS 10 some respondents expressed the view that the word 'benefits' is better than 'returns' because 'benefits' better reflects that the benefits obtained by the parent entity from the parent's involvement with the subsidiary are often non-financial and/or complementary. This is particularly so for public benefit entities. Respondents were of the opinion that 'returns', if retained, should be better articulated to explicitly include non-financial benefits and indirect/complementary benefits.
48. The IASB decided to retain the word 'returns' and include an example of non-monetary returns to illustrate that returns can be non-financial. This example in IFRS 10 discusses returns that are not available to other interest holders, for example, the use of an investor's assets in combination with the assets of the investee to enhance the value of the investor's other assets (for example, achieving economies of scale, cost savings, sourcing scarce products, gaining access to proprietary knowledge or limiting some operations or assets). IFRS 10 does not refer to other types of non-financial returns or indirect/complementary benefits.
49. The IPSASB project will need to consider whether to use the term 'returns', and if so, what additional guidance is required in respect of that term. The IPSASB project will also need to consider whether additional guidance is required in respect of complementary benefits.

Structured entities

50. In developing IFRS 10 the IASB initially proposed to have a separate section on assessing control of structured entities. Respondents to the IASB expressed the following concerns about the

proposed definition of structured entities and the proposal to have separate requirements addressing structured entities:

- (a) defining these types of entities could have unintended consequences, for example, excluding certain entities that don't have the characteristics stated in the definition;
- (b) the proposed definition of a structured entity would perpetuate the scope uncertainties that existed between IAS 27 (2008) and SIC-12 TITLE; and
- (c) the proposed definition of a structured entity had a narrower view of 'predetermination' in assessing control compared to the concept of 'autopilot' in SIC-12.

- 51. The IASB subsequently decided not to have different requirements for structured entities. The guidance in IFRS 10 on assessing control is therefore applied in a consistent manner to all entities in which the investor has an interest. IFRS 10 therefore superseded SIC-12 *Consolidation—Special Purpose Entities*.
- 52. The IPSASB project will need to consider how the requirements in IFRS 10 would apply to public sector entities set up to operate independently (for example, under autopilot arrangements) and whether any additional guidance is required.

Disclosure

- 53. Assessing the appropriateness of the disclosures in IFRS 12 for public sector entities is likely to be challenging. Coming to a decision on whether a departure from IFRSs is warranted will require that the Board forms an opinion about which disclosures are useful in a public sector context and the relative costs and benefits of disclosures. Many of the disclosures in IFRS 12 are new and they have not previously been applied by public sector entities. The IPSASB will need to consider what type of consultation will be required in order for it to make an informed assessment about the disclosure requirements in IFRS 12.
- 54. In developing IFRSs 10-12 the IASB gained insights into costs and benefits through its consultation processes including (i) both consultative publications (discussion papers, exposure drafts etc) and (ii) communications with interested parties (outreach activities, meetings etc). The IASB has prepared an effect analysis for IFRS 12⁷ which explains the IASB's reasons for developing IFRS 12 and some of the benefits and costs that were foreseen.
- 55. Extracts from the IASB's effect analysis follow.

From page 11:

One of the most important changes to financial reporting that arises from IFRS 10 and IFRS 12 is the improved disclosure requirements about both consolidated and unconsolidated entities. Previously, IAS 27 and SIC-12 contained limited disclosure requirements for subsidiaries and no disclosure requirements for unconsolidated structured entities. That lack of guidance was a frequent criticism of IAS 27 and SIC-12. The Financial Stability Board, regulators and others identified disclosures about risks associated with structured entities and other 'off balance sheet' entities as an area that urgently needed improvement. Users also requested improvements to risk disclosures, as well as other disclosures about consolidated entities.

⁷ *Effect Analysis IFRS 10 Consolidated Financial Statements and IFRS 12 Disclosure of Interests in Other Entities*, IASB, updated January 2012

IFRS 12 provides comprehensive disclosure requirements about a reporting entity's interest in other entities. We believe that this will address many of the criticisms about insufficient disclosure in this area in recent years. The new information should help users to evaluate the nature of, and risks associated with, a reporting entity's interest in other entities and the effects of those interests on its financial position, financial performance and cash flows.

From pages 38 and 39:

The improved requirements are designed to provide users with information to help them to gain a better understanding of the extent of the activities carried out by a reporting entity through its relationships with other entities. The new information that is disclosed should provide users with information that is useful when performing equity analysis and valuations.

These new disclosure requirements may represent costs for preparers complying with the additional disclosures. In our analysis, however, we have found that these costs should be somewhat mitigated because they will only apply to particular subsets of entities and because reporting entities are likely to already have some of the new information required.

Additionally, relatively few respondents who commented on the *Request for Views on Effective Date and Transition Methods* indicated that there would be significant costs in implementing the disclosure requirements in IFRS 12. Those costs that were mentioned usually pertained to one-time implementation costs. In addition, we think that an important benefit of the improved disclosures resulting from IFRS 12 will be the lower cost of capital. Academic research has shown that more transparent information leads to more efficient capital allocation because of a better assessment of risk and better pricing. This, in turn, will lead to a lower cost of capital.

56. Another factor that may influence the Board's analysis of IFRS 12 is a concern held by some IFRSs reporters and users about "disclosure overload". The IASB has acknowledged this concern about the overall level of disclosure required by IFRSs and some projects have looked at ways of addressing this issue.⁸ This project presents an interesting opportunity for the IPSASB to take a critical approach to disclosure, having regard to the objectives of financial reporting identified in Phase 1 of the conceptual framework.

Temporary Control and IFRS 5

57. IPSASs 6-8 all contain temporary control exemptions. These exemptions were based on the requirements in the equivalent IFRSs at the time those IPSASs were developed. For example, IPSAS 6 includes an exemption from the requirement to consolidate controlled entities if 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 12 months from acquisition and (b) management is actively seeking a buyer. These temporary control exemptions were removed from IFRSs when IFRS 5 was issued. For example, in IFRS 10 (and the most recent version of IAS 27) subsidiaries

⁸ The Institute of Chartered Accountants of Scotland (ICAS) and the New Zealand Institute of Chartered Accountants (NZICA) have issued a report, *Losing the excess baggage – reducing disclosures in financial statements*. The Financial Executives Research Foundation (FERF) and KPMG have produced a joint report, *Disclosure Overload and Complexity: Hidden in Plain Sight*, which examines the effect of increased financial disclosures from 2004-2010. The report observes that more financial disclosures are not necessarily better, and recommends financial disclosure enhancement rather than expansion. The IASB has considered concerns about disclosure overload in the context of its projects on revenue, leases and insurance (IASB staff paper, March 2011).

classified as held for sale are consolidated, but the assets and liabilities are classified as held for sale in accordance with IFRS 5 (IFRS 5 paragraph 8A).

58. In September 2011 IPSASB staff presented an issues paper on whether the temporary control exemption in IPSAS 6 should be retained when developing the Exposure Draft of a revised IPSAS 6. Staff set out three options for discussion.
- (a) Option A: Leave the temporary control exemption in IPSAS 6.
 - (b) Option B: Remove the temporary control exemption from IPSAS 6 and include no guidance on this topic.
 - (c) Option C: Remove the temporary control exemption from IPSAS 6 and commence a project to develop an IPSAS based on IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*.
59. IPSASB members had mixed views on this issue and did not make a firm decision at that time. A suggestion made at this time was that the IPSASB should consider whether the requirements in IFRS 5 would result in higher quality information for users. Staff consider that all exemptions from the scope and requirements of the standards, including the temporary control exemption, should be reexamined as part of this project.

Action Requested:

AGREE that the public sector specific modifications in IPSASs 6-8, and the other identified issues should be used as the starting point for identifying possible departures from IFRSs.

AGREE that the definition and the application of the notion of control should be the starting point for the project, with consideration being given to developing an IPSAS equivalent to IFRS 5.

PROVIDE FEEDBACK on other key issues that should be addressed when applying the Rules of the Road to IFRS 10-12, IAS 27 (as amended in 2011) and IAS 28 (as amended in 2011), in particular:

- (a) Which other areas of work should have priority?
- (b) Are there some issues where the Board considers that it should be presumed that a public sector modification will be needed?
- (c) Are there some topics/issues which the Board considers should be critically examined?

Application of uniform accounting policies

60. Both IPSAS 6 and IFRS 10 require the use of uniform accounting policies in consolidated financial statements for like transactions and other events in similar circumstances. Many public sector entities have investments in entities such as GBEs which apply different accounting standards. As a result of the global financial crisis a number of governments now have ownership interests in banks and other financial institutions. The impact of different accounting policies used by the controlled entities can be material in the context of the consolidated financial statements.

61. Public sector entities that are preparing consolidated financial statements have to decide which of these accounting policy differences are:
- (a) in respect of like transactions and other events in similar circumstances; and
 - (b) material.
62. They must then make adjustments for these accounting policy differences. A clear explanation of the public sector reason for modifications is one way in which the IPSASB can assist constituents to interpret the phrase “like transactions and other events in similar circumstances”. The existence of a public sector reason for making a modification to a standard may mean that the transactions and events are dissimilar between the private and public sector, and that no consolidation adjustment is required for deliberate differences in accounting policies between IPSASs and IFRSs.

Action Requested:

NOTE the importance of clearly documenting reasons for modifications to IFRSs

Other public sector guidance

63. This section describes how some standard setters have responded to public sector consolidation issues, including establishing specific requirements or additional guidance. This section is not intended to be comprehensive – rather it identifies matters that the IPSASB may consider when applying the Rules of the Road and developing public sector specific guidance.

Guidance – Australia

64. The Australian Accounting Standards Board (AASB) is in the process of developing integral implementation guidance for not-for-profit entities applying AASB 10 *Consolidated Financial Statements* (AASB 10 is based on IFRS 10). The proposed guidance explains and illustrates how the principles in AASB 10 apply from the perspective of not-for-profit entities in the private and public sectors, particularly to address circumstances where a for-profit perspective does not readily translate to a not-for-profit perspective. A copy of the draft guidance (as at April 2012) is included as agenda item 8.3. An Exposure Draft of the proposed implementation guidance is expected to be issued shortly.
65. Issues addressed in the guidance include, but are not limited to, the following:
- (a) Control is not limited to circumstances where the investor has a financial investment in the investee (IG3 and IG17).
 - (b) Returns may be non-financial – they may include providing goods or services to the investor or other parties that assist in achieving or furthering the investee’s objectives (IG4). However, on its own, having congruent objectives is insufficient to conclude that there is control (IG8).
 - (c) Rights that give an investor power over an investee: The guidance gives additional examples of such rights (IG7 and IG8).
 - (d) Examples of rights that are presently exercisable, although they are not being exercised (Example IG1A).

- (e) An entity may have statutory independence for some of its functions but be controlled (IG8).
 - (f) Dependence on government funding does not necessarily mean that an entity is controlled by the government (IG10).
 - (g) Examples of substantive rights and protective rights in a not-for-profit context (IG11-IG15).
66. The proposed AASB 10 guidance may be useful in helping the IPSASB consider the nature and location of additional guidance in an IPSAS based on IFRS 10.

Action Requested:

NOTE that the AASB is in the process of developing guidance for not-for-profit entities applying AASB 10 (the Australian equivalent to IFRS 10).

PROVIDE FEEDBACK on the issues addressed in the draft AASB guidance that should be considered when developing public sector examples.

Guidance – France

67. Standard 7 *Financial Assets* (section 1.2.1.3 *Restrictions on Control*)⁹ sets out the criteria and indicators that are used to establish control. These are similar to the requirements of IPSAS 6. Standard 7 also notes that application of these criteria and indicators may not be adequate to determine the effectiveness of the central government's control over the entities in question. There can be cases where the central government's control is restricted by severe provisions that prevent it from benefiting from the entity's activities. These severe provisions may be external (foreign) or internal (for example, legislation that requires the central government to waive any benefits that it could obtain from the entity's activities). Standard 7 states that such exceptional circumstances warrant a thorough examination of the mandate and activities of the entities concerned to determine whether or not control is severely restricted.
68. Standard 7 addresses a key public sector issue – the need to consider cases in which a government may not benefit from an entity's activities.

Guidance – New Zealand

69. The New Zealand Accounting Standards Board (NZASB) is currently in the process of developing domestic financial standards based on IPSASs. An Exposure Draft of the proposed domestic Standard, Public Benefit Entity IPSAS 6 *Consolidated and Separate Financial Statements* (PBE IPSAS 6) is due to be issued shortly. The NZASB is trying to minimize the possibility that entities will be required to change accounting policies more than once in a short period of time. In light of the IPSASB's intention to revise IPSAS 6-8, ED PBE IPSAS 6 contains, as an interim measure, the existing domestic guidance on assessing control be retained in PBE IPSAS 6.

⁹ Central Government Accounting Standards, France, (July, 2011)

70. Two key issues that are addressed in this guidance are:
- (a) “Irreversible predetermined mechanisms” or “autopilot arrangements”. This is where the policies that guide the activities of an entity have been predetermined and are unable to be modified. In such cases, a power element is not necessary, although the benefit element is still required. Any party that has established such an entity, and has ownership benefits, has control. This circumstance can often occur when trusts are formed by public sector entities. PBE IPSAS 6 proposes that, in this circumstance, no power element is required for the entity to be controlled.
 - (b) Benefit from complementary activities. The guidance explains that the controlling entity may obtain ownership benefits where there is a supply of goods or services to a third party by the possible controlled entity, and that supply of goods or services meets an operating objective of the controlling entity. That is, the controlling entity may benefit from complementary activities. Because it can be difficult to identify clearly whether a given circumstance establishes an entitlement to receive the benefits resulting from complementary activities, the guidance takes the position that such entitlement arises when all three of the following conditions apply:
 - (i) the supply of goods or services by the possible controlled entity is directly consistent with, and is likely to enhance, the operating objectives of the controlling entity, and
 - (ii) determination of the nature of the goods or services to be supplied is a direct consequence of the exercise of the controlling entity’s decision-making ability over the activities of the possible controlled entity, and
 - (iii) the controlling entity is relieved, as a result of the activity of the possible controlled entity, of an actual or constructive obligation to provide such supply; or the controlling entity has a right to receive a future service delivery from the possible controlled entity which is not subject to additional funding to be provided by the controlling entity.
71. The proposed New Zealand guidance highlights two public sector issues and possible ways of dealing with them.

Guidance – UK

72. HM Treasury has developed technical guidance which considers whether an entity should be classified to the public or private sectors within national accounts¹⁰. The purpose of the guidance is to align, to the extent possible, the financial reporting requirements in UK GAAP with the Office for National Statistics tests of control. International statistical requirements are discussed in the next section of this memo.
73. The *Financial Reporting Manual 2012-13* (FReM) explains that the departmental boundary is similar to the concept of a group under generally accepted accounting practice, but is based on control criteria used by the Office for National Statistics to determine the sector classification of the relevant sponsored bodies. Except where legislation requires otherwise, the standards dealing with group financial statements are applied to executive non-departmental and similar public bodies only

¹⁰ Class (2010)1 Sector Classification, HM Treasury, March 2010

if those entities are designated for consolidation (by order of the relevant authority under statutory instrument). Such designation reflects the Office for National Statistics' classification of an entity to the central government sector. Extracts from the FReM are set out below.

Extracts from UK FReM 2012-13

The departmental boundary is similar to the concept of a group under generally accepted accounting practice, but is based on control criteria used by the Office for National Statistics to determine the sector classification of the relevant sponsored bodies. Except where legislation requires otherwise, executive non-departmental and similar public bodies that satisfy the IAS 27, IAS 28, IAS 31 and SIC 12 criteria for consolidation as subsidiary undertakings, associated undertakings or joint ventures will be accounted for in accordance with IAS 27, IAS 28 and IAS 31 only if they are designated for consolidation by order of the relevant authority under statutory instrument, which will reflect the ONS's [Office for National Statistics] classification of an entity to the central government sector.

Statistical reporting requirements

74. The requirements regarding when to consolidate an entity differ between IPSASs and GFS. The IPSASB has a current project which is analyzing the differences between the revised *Government Finance Statistics Manual* 2008 (GFSM 2008) and IPSASs, and evaluating the extent to which further harmonization between statistical reporting guidance and IPSASs might be feasible. Approval to issue a Consultation Paper *Alignment of IPSASs and Government Finance Statistics Reporting Guidelines* is being sought at this meeting (refer agenda item 3). For ease of reading, relevant extracts from the draft Consultation Paper are set out below.

Extracts from Draft Consultation Paper

Alignment of IPSASs and Government Finance Statistics Reporting Guidelines

2. Reporting entity

- 2.9 One of the fundamental differences between GFS reporting guidelines and IPSASs relates to the definition of the reporting entity and the process of consolidation (collectively often referred to as "identification of the reporting entity boundary"). Under GFS reporting guidelines, as described in Chapter 2 of the 2012 GFSM and in the 2008 SNA, Chapter 4, institutional units are aggregated and consolidated into statistical sectors and subsectors. The focus of statistical reporting is primarily on consolidated sectors and subsectors. Although it is theoretically possible to create GFS reports for individual institutional units, separate statistical reports for individual units are usually not disseminated.¹¹ Each individual entity in the economy is analyzed with respect to its autonomy of decision making, to determine if it can be considered an institutional unit.
- 2.10 Those government-controlled units that are primarily engaged in nonmarket (including redistributive) activities are included within the "general government sector" (GGS). Although all resident government-controlled entities, including public corporations engaged in market activities, are included within the public sector, nonmarket activities determine the delineation

¹¹ The United Nations Fundamental Principles of Official Statistics states that individual data collected by statistical agencies for statistical compilation, whether they refer to natural or legal persons, are to be strictly confidential and used exclusively for statistical purposes. However, for government units, for reasons of fiscal transparency, this principle is not always adhered to. (Cfr.Reg. (European Commission) No.223/2009 Chapter V.)

- of the GGS, as a distinct subsector within the public sector. The GGS does not include entities engaged in market activities. Where two units are both in the GGS, the consolidated position eliminates transactions and positions between the two units.
- 2.11 In IPSASs the “reporting entity” is a government or other public sector organization, program or identifiable activity that prepares general purpose financial reports (GPFRs)¹². The reports may be prepared on either a compulsory or voluntary basis. A key characteristic of a reporting entity is that there are users who depend on GPFRs for information about the entity. A reporting entity may be a “group reporting entity.”
- 2.12 A group reporting entity consists of two or more separate entities that present GPFRs as if they are a single entity. A group reporting entity is identified where one entity has the authority and capacity to direct the activities of one or more other entities so as to benefit from the activities of those entities. It may also be exposed to a financial burden or loss that may arise as a result of the activities of entities whose activities it has the authority and capacity to direct.¹³ If these conditions are met then the entity is described as a “controlling entity,” with control defined according to the principle of the exercisable power to govern the financial and operating policies of another entity.
- 2.13 IPSASs also have a requirement that a reporting entity provide segmental reporting (see IPSAS 18). A reporting entity provides disaggregated financial information about each of its segments. The information provided includes segment assets, liabilities, revenue, and expenses. Segments are usually defined either in terms of geographical regions or services.
- 2.14 The requirement to consolidate entities differs in IPSASs and GFS. Under IPSAS 6, Consolidated and Separate Financial Statements, consolidated financial statements are the financial statements of a group of entities presented as those of a single entity. This means that a controlling entity will consolidate the financial statements of all of its controlled entities, irrespective of whether they are (a) resident units, (b) market /non-market entities, or (c) the IPSAS equivalent of a market entity, i.e. a “government business enterprise” (GBE)¹⁴. This contrasts with the GGS consolidation approach, described above, where nonresident and market entities are not fully consolidated into the GGS.
- 2.15 Nevertheless, IPSASs provide for the disclosure of financial information about the GGS. IPSAS 22, Disclosure of Financial Information about the General Government Sector, specifically sets aside the application of IPSAS 6, Consolidated and Separate Financial Statements while retaining the application of all other IPSASs. This allows an aggregate presentation, which can reconcile the statistical reporting boundary for the GGS with the IPSAS reporting boundary.

¹² Conceptual Framework Exposure Draft 1 (CF—ED1), *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Role, Authority, and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity*, paragraphs 4.1–4.6

¹³ Ibid, paragraphs 4.7–4.12.

¹⁴ A GBE is defined to be a public sector entity that (a) has the power to contract in its own name, (b) has been assigned the financial and operational authority to carry on a business, (c) sells goods and services in the normal course of its business to other entities at a profit or full cost recovery, and (d) is not reliant on continuing government funding to be a going concern. (See IPSAS 1, paragraph 7.) GBEs are not required to apply IPSASs. Instead they apply International Financial Reporting Standards (IFRSs) or the private sector accounting standards for their national jurisdiction.

75. There are four categories of issues in the draft Consultation Paper:

- (a) Category A – Issue now resolved
- (b) Category B – Scope for increasing alignment through changes to IPSASs
- (c) Category C – Scope for increasing alignment through changes to statistical reporting guidelines
- (d) Category D – Differences needing to be managed through systems design, data collection and/or mapping.

The reporting entity differences are discussed under subheadings A, B and D in Table 2 of the draft Consultation Paper.

Table 2 Alignment Issues—Resolution and Proposals

A. Issue resolved		
	<i>Issue</i>	<i>Resolution</i>
A1	Scope of the reporting entity and sector reporting	IPSAS 22, <i>Disclosure of Financial Information About the General Government Sector</i> (a) encourages disclosure of information about the general government sector, (b) specifies rules when a government elects to make such disclosures; and, (c) requires a government's investment in public corporations to be recognized at the carrying amount of investees' net assets. (Also see B1 and D1.)
B. Scope for increasing alignment through changes to IPSASs <i>(Discussed further in Section 4.)</i>		
B1	Reporting entity definition	Align the definition of "control" in IPSAS 6 with the SNA definition. Included in IPSASs 6–8 revision project.
D. Differences needing to be managed through system design, data collection, and/or mapping <i>(Discussed further in Section 6.)</i>		
D1	Reporting entity definition	The basic conceptual difference remains and will need to be managed, through identification of data that relates to the GGS.

Further extracts from section 4 of the Draft Consultation Paper

Changes Already Included in the IPSASB's Work Plan

Reporting Entity Definition (Issue B1)

4.5 The basic conceptual difference between the two different definitions of a reporting entity will always remain. However there appears to be scope to align the definition of "control" in IPSAS 6 with the SNA definition. The IPSASB has approved a project, for its current work plan, to revise IPSAS 6, Consolidated and Separate Financial Statements, IPSAS 7, Investments in Associates, and IPSAS 8, Interests in Joint Ventures. This change will be considered as part of that project.

76. The alignment project has identified that there is a basic conceptual difference between the reporting entity between financial reporting standards and statistical reporting and suggested that there may be some scope to align the concept of control.
77. The financial reporting definition of control is fundamental to the requirements of IFRSs 10-12. Preliminary considerations from the perspective of this project lead the staff to consider that redefining the financial reporting definition of control to align with statistical reporting would make it virtually impossible to create an IPSAS version of the IASB's standards. There may also be implications for the Conceptual Framework project. A simpler approach may be to amend IPSAS 22 to provide requirements for governments to present the general government as a sector in accordance with the principles in IPSAS 18 *Segment Reporting*, but using recognition and measurement consistent with statistical reporting.

Action Requested:

CONFIRM that the definition of control should be based on that in IFRSs

PROVIDE FEEDBACK on the suggestion that governments could present information on the general government as a sector in accordance with the principles in IPSAS 18.

Project timetable

78. Major project milestones have been revised and are presented below. These milestones are based on the assumption that this project is based on the Rules of the Road. If the Board prefers that the project is not based on IPSAS, the timeline will need to be extended and is likely to include the need to issue a Consultation Paper.

Major Project Milestones	Expected Completion
Discussion of issues	June 2012
Consider Exposure Drafts	Sep- Mar 2013
Approve EDs (4 month comment period)	June 2013
Review of responses to EDs and development of IPSASs	Dec 2013-Mar 2014
Approve Final IPSASs	2014

Action Requested:

AGREE the revised project milestones.

Conclusion

79. Having regard to the issues identified in this paper, and subject to feedback received at this meeting, staff propose that the following papers be brought to the next meeting:
- (a) Drafts of the proposed new standards showing an outline of the proposed modifications, together with a proposed rationale for the modification (based on the criteria in the Rules of the Road). Detailed drafting would occur once the Board had agreed to proceed with a proposed modification.
 - (b) A paper specifically addressing issues associated with control and the proposed responses to these issues. This could include drafts examples in the form of implementation guidance.
 - (c) A separate paper considering the suitability of the disclosures in IFRS 12.
80. In order to begin this work staff need direction from members as to whether they support the accounting treatments in IFRSs and the main areas where additional guidance is likely to be required.

Action Requested:

PROVIDE FEEDBACK on papers to be brought to the next meeting.

Appendix A: Links to IPSASB's Conceptual Framework project

Phase 1 of the IPSASB's Conceptual Framework project has addressed the composition of a reporting entity. Decisions made in developing the section on the reporting entity are listed below.

- (a) The Framework is to include a section dealing with the reporting entity and acknowledge that a reporting entity may include two or more separate entities. (Agreed September 2011)
- (b) The section dealing with the group reporting entity is to be deleted. The BC is to explain that the criteria for determining which entities will be included within a group reporting entity will be developed at standards level. (Agreed September 2011)
- (c) The observations that the Framework does not identify the reporting entity and this is not the role of the Framework, are to be deleted. (Agreed September 2011)
- (d) Text that may be interpreted to imply segments of an entity are likely to be separate reporting entities in their own right are to be "softened". (Agreed September 2011)
- (e) The revised approach to the reporting entity section (considered in December 2011) is to be adopted. It is to be further developed to reflect that key characteristics of a public sector reporting entity are existence of users and the raising and use of economic resources for the provision of goods or services or other activities. (Agreed December 2011)
- (f) The Appendix referring to the statistical bases of reporting is to be updated to reflect that in some circumstances consolidation within a sector may be allowed or required. (Agreed December 2011)



INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS BOARD

PROJECT BRIEF AND OUTLINE (*as at September 2011*)

- 1. Subject—Consolidated and Separate Financial Statements, Associates and Joint Arrangements (Revision of IPSASs 6–8)**
 - 1.1 In May 2011, the IASB issued the following standards for which the IPSASB has equivalent standards:
 - 1.2.1 IFRS 10, *Consolidated Financial Statements*;
 - 1.2.2 IFRS 11, *Joint Arrangements*;
 - 1.2.3 IFRS 12, *Disclosure of Interests in Other Entities*;
 - 1.2.4 IAS 27 (revised 2011), *Separate Financial Statements*; and
 - 1.2.5 IAS 28 (revised 2011), *Investments in Associates and Joint Ventures*.
 - 1.2 The IASB has issued these as a “package of five,” with effective dates for annual periods beginning on or after January 1, 2013. Earlier application permitted so long as each of the other standards in the package of five is also early applied.
 - 1.3 To maintain alignment with IFRSs, this project will:
 - 1.3.1 Update IPSAS 6, *Consolidated and Separate Financial Statements* and relocate guidance relating to consolidated financial statements in a separate standard;
 - 1.3.2 Update IPSAS 7, *Investments in Associates*;
 - 1.3.3 Update IPSAS 8, *Interests in Joint Ventures*; and
 - 1.3.4 Locate all disclosures relating to interests in other entities in a separate standard.
- 2. Project Rationale and Objectives**
 - 2.1 One of the objectives of the IPSASB is to maintain alignment with IFRSs for its standards that are based on an underlying IFRS. The issue of new and revised underlying standards by the IASB means that is an appropriate time to revise the relevant IPSASs.
 - (a) Issues Identified**
 - 2.2 Should the temporary control exemption from consolidation in IPSAS 6 be retained?
 - 2.3 Should the scope of the project include consideration of whether the term control should continue to be used and whether the revised definition of control is appropriate?

2.4 Should the scope of the project include consideration of whether all controlled entities should be consolidated?

2.5 How should the project address the consolidation of structured entities?

(b) Objectives to be achieved

2.6 The ultimate objective of the project is to revise IPSASs 6–8 and issue a separate IPSAS on consolidated financial statements and a new IPSAS on disclosure of interests in other entities.

(c) Link to IFAC and IPSASB Strategic Plans

i. Link to IPSASB Strategy

2.7 One of the IPSASB's strategic priorities for the period 2010–2012 is public sector critical projects which could be either public sector specific or IASB convergence projects. The revision of IPSASs 6–8 is an IASB convergence project to maintain alignment with IFRSs.

ii. Link to IFAC Strategic Plan

2.8 The IFAC Strategic Plan for 2011–2014 includes a strategy on IFAC's commitment to the development, adoption and implementation of international standards, including those for the public sector. Revising IPSASs 6–8 supports this strategy by further developing these standards.

3. Outline of the Project

(a) Project Scope

3.1 The scope of this project is to:

3.1.1 Update IPSAS 6 and relocate guidance into a new standard to reflect the IASB's issue of IFRS 10 and IAS 27 (revised 2011);

3.1.2 Update IPSAS 7 to reflect the IASB's issue of IAS 28 (revised 2011);

3.1.3 Update IPSAS 8 to reflect the IASB's issue of IFRS 11; and

3.1.4 Develop a new standard to locate all disclosures related to interests in other entities to reflect the IASB's issue of IFRS 12.

(b) Major Problems and Key Issues that should be addressed

3.2 In addition to the Key Issues set out below, a “rules of the road” analysis will be undertaken on the proposed changes to help determine whether the changes need to be adapted to apply in the public sector. That process may identify further key issues.

Key Issue #1—Should the temporary control exemption from consolidation in IPSAS 6 be retained?

- 3.3 IPSAS 6 requires that a controlled entity be excluded from the consolidated financial statements where 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 “temporary control” exemption).
- 3.4 This exemption was removed from IAS 27 with the issue of IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations* in March 2004. IFRS 5 also includes requirements where a subsidiary is classified as held for sale. It is unclear as to whether or not there is a public sector specific reason for retention of the temporary control exemption in IPSAS 6 or whether there is a need for a standard based on IFRS 5.

Key Issue #2—Should the scope of the project include consideration of whether the term control should continue to be used and whether the revised definition of control is appropriate?

- 3.5 IPSAS 6 uses control as the basis for determining which entities are consolidated. A key issue will be to determine whether the project should include consideration of whether the term control should continue to be used. This is an issue because (a) Phase 1 of the IPSASB’s Conceptual Framework project does not use the term control when referring to which entities to include in the group reporting entity and (b) IFRS 10 includes a significant amount of guidance on the assessment of control.
- 3.6 If use of the term control is appropriate, then the revised definition of control that is used in IFRS 10 needs to be explored to determine whether it is appropriate for use by public sector entities.

Key Issue #3—Should the scope of the project include consideration of whether all controlled entities should be consolidated?

- 3.7 IPSAS 6 requires all controlled entities to be consolidated unless the temporary control exemption applies. A key issue will be to determine whether the project should include consideration of whether all controlled entities should be consolidated. This is an issue because of the interaction with Key Issue 1 above relating to the temporary control exemption and the proposed project on Government Business Enterprises (GBEs) which may consider how GBEs should be included in consolidated financial statements (see Agenda Paper 7.1.4).

Key Issue #4—How should the project address the consolidation of structured entities?

- 3.8 IPSAS 6 does not include guidance on how to determine whether structured entities are controlled by the controlling entity, e.g., where a controlling entity does not “direct the activities of” a controlled entity. A key issue will be to determine how to address this issue. This Key Issue also relates to Key Issue 3.

4. Describe the Implications for any Specific Persons or Groups

(a) Relationship to IASB

- 4.1 This project is based upon IFRSs. The IASB is expected to issue an Exposure Draft (ED) in mid-2011 proposing amendments to IFRS 11. The ED will propose a definition for investment entities. For those entities that meet the definition, they will be required to measure investments in entities that they control at fair value, with changes in fair value recognized in profit or loss rather than consolidating these investments.

(b) Relationship to Other Standards, Projects in Process or Planned

- 4.2 The issue of the package of five standards includes consequential amendments to a number of other standards. These consequential amendments will be considered as a part of this project. Apart from these amendments, there do not appear to be implications for other IPSASs. As the project develops, potential implications may be identified and will be dealt with as they arise. Projects being undertaken by the IASB and IFRIC will also be monitored as the project develops.

(c) Other—Government Finance Statistics (GFS)

- 4.3 One aspect of the IPSASB's strategy is to consider convergence with the statistical basis of accounting where appropriate. Consolidation is one area where there are differences between IPSASs and GFS. The IPSASB has a separate project on *Alignment of IPSASs and Public Sector Statistical Reporting Requirements*. It is unclear at this stage which project will include a comparison of the differences between the two bases.

5. Development Process, Project Timetable and Project Output

(a) Development Process

- 5.1 The development of outputs will be subject to the IPSASB's formal due process. The issuance of documents for public comment will be subject to the usual IPSASB voting rules. As the project progresses, regular assessments will be made to confirm the proposed path in the project timetable remains the most appropriate.

(b) Project timetable

Major Project Milestones	Expected Completion
Approve Project Brief	June 2011
Discussion of issues and development of Exposure Drafts (EDs) (July–June 2012)	
Approve EDs (4 month comment period)	June 2012
Review of responses to EDs and development of IPSASs	
Approve Final IPSASs	2013

(c) **Project output**

- 5.2 The initial output will be Exposure Drafts. The ultimate output will be revised and new IPSASs.

6. Resources Required

(a) **Task Force/Subcommittee**

- 6.1 A Task Based Group will assist in exploring the issues.

(b) **Staff**

- 6.2 It is envisaged that 0.5 Full Time Equivalent (FTE) will be required to resource the project.

(c) **Factors that might add to complexity and length**

- 6.3 Factors that might add to the complexity and length of the project include:

- 6.3.1 The interaction between this project and the proposed project on GBEs.
6.3.2 The interaction between this project and the development of the Conceptual Framework.

7. Important Sources of Information that Address the Matter being Proposed

- 7.1 Potential sources of information regarding entity combinations include:

- 7.1.1 IFRSs 10–12 and revised IAS 27 and IAS 28.
7.1.2 The IASB's project on Investment Entities.

Process for Reviewing and Modifying IASB Documents

October 2008



**International Federation
of Accountants**

Introduction

The mission of the International Public Sector Accounting Standards Board (IPSASB) is:

“To serve the public interest by developing high-quality accounting standards for use by public sector entities around the world in the preparation of general purpose financial statements.”

Accomplishing this mission will enhance the quality and transparency of public sector financial reporting and provide better information for public sector financial management and decision-making.

The IPSASB develops accrual-based International Public Sector Accounting Standards (IPSASs) to address public sector financial reporting issues in two different ways:

- By addressing public sector financial reporting issues (a) that have not been comprehensively or appropriately dealt with in existing International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB), or (b) for which there is no related IFRS; and
- By developing IPSASs that are converged with IFRSs by adapting them to the public sector context.

The following pages set out the process for considering IASB documents for convergence. The IPSASB will use the analysis resulting from this process to determine whether identified public sector issues warrant departures from the IASB document when developing the related IPSASB document.

It is important to note that the IPSASB will use professional judgment in reaching its conclusions. After reaching a conclusion, the IPSASB will apply its standard-setting due process in developing final standards. As part of this due process, reasons for conclusions will be documented in the related Basis for Conclusions.

This process of reviewing IASB documents is ongoing and will be regularly assessed to determine if any changes are needed to enhance the process.

Step 1: Are there public sector issues that warrant departure?

The goal of this step is to assess public sector issues to determine if they warrant a departure in recognition or measurement, or in presentation or disclosure.

In determining whether public sector issues warrant a departure from an IASB document, the IPSASB will consider the following:

- i) Whether applying the requirements of the IASB document would mean that the objectives of public sector financial reporting would not be adequately met (see IPSAS 1 paragraph 15 and Consultation Paper, Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities, September 30, 2008).
- ii) Whether applying the requirements of the IASB document would mean that the qualitative characteristics of public sector financial reporting would not be adequately met (see IPSAS 1, Appendix B and Consultation Paper, Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities, September 30, 2008).
- iii) Whether applying the requirements of the IASB document would require undue cost or effort.

All decisions will be made in the context of considering:

- Consistency with the IPSASB Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities as it develops;
- Internal consistency with existing IPSASs; and
- Consistency with the statistical bases.

Items that might affect the above consideration include:

- The existence of sovereign powers;
- The existence of contributed/donated assets or non-exchange activities;
- The existence of non-cash-generating activities or assets;
- The impact of social benefits;
- Accountability/stewardship differences;
- Governance or management of structural differences;
- Sustainability issues; and
- Differences related to the structure or service potential of assets.

If the consideration of Step 1 identifies public sector issues that warrant departure, go to Step 2.

If the public sector issues do not warrant departure, go to Step 4.

Step 2: Should a separate public sector project be initiated?

The goal of this step is to determine whether to initiate a separate public sector project.

In assessing whether to initiate a separate public sector project, the nature of the identified public sector issue would be considered.

Considering the nature of the identified public sector issue will arise, for example, when that public sector issue is not dealt with at all in an IASB document. In this case, it is likely that a separate public sector project will be initiated. As an example, the IPSASB initiated its project on service concession arrangements because the IASB's International Financial Reporting Interpretations Committee dealt only with the operator side of these transactions. Public sector entities are often involved in such transactions as grantors. The lack of guidance on such an important issue resulted in approval by the IPSASB of a new project on service concessions arrangements for the public sector.

In other situations, the IASB document may deal with an issue but may not address public sector circumstances, or if it does, does not do so adequately. In deciding whether to amend an IASB document or to initiate a separate public sector project in that situation, it will be important to assess (a) the importance and prevalence of the issue in the public sector, and (b) the adequacy with which it has been dealt with in the IASB document.

If the consideration of Step 2 identifies public sector issues that warrant a separate public sector project, a project brief would be prepared for the IPSASB's approval and the project would follow the standard-setting due process.

If the public sector issues can be addressed within a document that is converged with the related IASB document, go to Step 3.

Step 3: Modify IASB documents

The goal of this step is to set parameters for modifying an IASB document to address public sector departures.

When a decision has been made that public sector issues warranting departure can be addressed within an IPSASB document that is converged with a related IASB document, with some modification, it is important to establish parameters for the extent of modification. Modifications would only be made to address the public sector issue that triggered the amendment. In determining appropriate modifications, the following would be considered:

- i) Recognition and measurement requirements may be modified if doing so would result in the objectives or qualitative characteristics of public sector financial reporting being better met, or there would be undue cost or effort in applying the requirements.
- ii) Where appropriate, deletions from, or other amendments to, an IASB document could be replaced by an alternative that better achieves the objective of public sector financial reporting.
- iii) Amendments would occur to eliminate options in accounting treatments if one option is clearly inappropriate for the public sector. Likewise, options in accounting treatments could be added if doing so would result in the objectives of public sector financial reporting being better met.
- iv) Guidance may be added that provides public sector context.
- v) Disclosures in an IASB document may be added or deleted where (a) they relate to recognition and measurement requirements in accordance with i) above, or (b) the objectives or qualitative characteristics of public sector financial reporting would be better met or there would be undue cost or effort in applying the disclosures.
- vi) Public sector examples may be added. Examples would be deleted if they are clearly inappropriate for or inapplicable to the public sector.
- vii) Amendments may be made to the scope or other aspects for consistency with existing IPSASs.

Having amended the IASB document as necessary, go to Step 4.

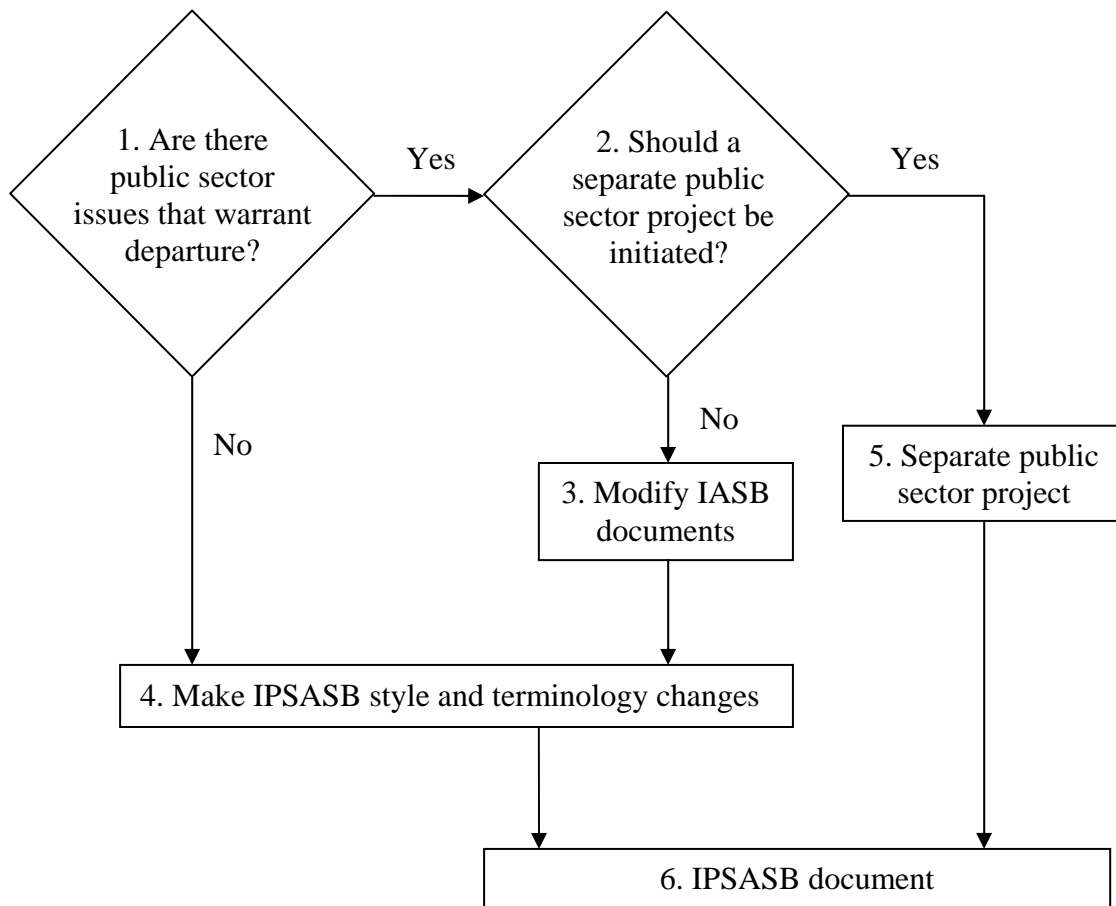
Step 4: Make IPSASB style and terminology changes to IASB documents

The goal of this step is to identify changes in style and terminology to be applied to all IPSASs.

In many cases, the style and terminology of an IPSASB document that is converged with a related IASB document will require changes. In that context, amendments, which will be limited, could result from the following considerations:

- i) The text and style of the IASB document will be maintained as much as possible. Changes in style would simplify or clarify the document from a public sector perspective, and would be consistent with the prescribed style for IPSASB documents.
- ii) A boxed rubric will be included at the front of each IPSAS. The rubric will identify the material that constitutes the IPSAS, and the documents that provide the context in which the IPSAS should be read.
- iii) Definitions in IASB documents that have no public sector context may be deleted.
- iv) References to an IASB document for which an equivalent IPSAS has not been issued will be replaced with “the relevant international or national accounting standard dealing with [specific topic].”
- v) Certain terminology changes may be made to better reflect the public sector scope of the documents. For example, “business” will be replaced with “entity” or “operation.”
- vi) The authoritative or non-authoritative nature of Appendices will be addressed within individual IPSASs.
- vii) Each IPSAS will be accompanied by a Basis for Conclusions that does not form part of that IPSAS. The Basis for Conclusions will focus on the modifications to the IASB document. Specifically, it will include a detailed description of the public sector issue, the rationale for departing from the related IASB document, and the implications of the changes.
- viii) Initial adoption and transitional provisions may differ to reflect public sector circumstances.

Process for Reviewing and Modifying IASB Documents



DRAFT EXPOSURE DRAFT ED XX

ACCOUNTING STANDARD AASB 2012-X
CONSOLIDATED FINANCIAL STATEMENTS –
AUSTRALIAN IMPLEMENTATION GUIDANCE
FOR NOT-FOR-PROFIT ENTITIES

Objective

- 1 The objective of this Standard is to add implementation guidance to Accounting Standard AASB 10 *Consolidated Financial Statements* for application by not-for-profit private sector and public sector entities, and to make additional amendments to AASB 10 and to:
- (a) AASB 11 *Joint Arrangements*;
 - (b) AASB 12 *Disclosure of Interests in Other Entities*;
 - (c) AASB 127 *Separate Financial Statements*; and
 - (d) AASB 128 *Investments in Associates and Joint Ventures*.

Application

- 2 This Standard applies to:
- (a) each entity that is required to prepare financial reports in accordance with Part 2M.3 of the *Corporations Act 2001* and that is a reporting entity;
 - (b) general purpose financial statements of each other reporting entity; and
 - (c) financial statements that are, or are held out to be, general purpose financial statements.
- 3 This Standard applies to annual reporting periods beginning on or after 1 January 2013.
- 4 This Standard may be applied to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2013, provided that AASB 10, AASB 11, AASB 12, AASB 127 and

AASB 128 are also applied to the same period. If an entity applies this Standard to such an annual reporting period, it shall disclose that fact.

- 5 This Standard uses underlining, striking out and other typographical material to identify some of the amendments to a Standard, in order to make the amendments more understandable. However, the amendments made by this Standard do not include that underlining, striking out or other typographical material.

Amendments to AASB 10

- 6 Paragraph Aus3.3 is amended as follows (new text is underlined and deleted text is struck through):

Aus3.3 This Standard may be applied ~~by for-profit entities, but not by not-for-profit entities,~~ to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2013. If a for-profit entity ~~an entity~~ applies this Standard to such an annual reporting period, it shall disclose that fact and apply AASB 11 *Joint Arrangements*, AASB 12 *Disclosure of Interests in Other Entities*, AASB 127 *Separate Financial Statements* (August 2011) and AASB 128 *Investments in Associates and Joint Ventures* (August 2011), at the same time.

- 7 Paragraph Aus3.6 is added as follows:

Aus3.6 Appendix E *Australian Implementation Guidance for Not-for-Profit Entities* explains and illustrates how the principles in the Standard apply from the perspective of not-for-profit entities in the private and public sectors, particularly in circumstances where the for-profit perspective reflected in the body of the Standard and the other appendices does not readily translate to a not-for-profit perspective.

- 8 Appendix E *Australian Implementation Guidance for Not-for-Profit Entities* is added as presented in later pages of this Standard.

Amendment to AASB 11

- 9 Paragraph Aus2.3 is amended as follows (new text is underlined and deleted text is struck through):

Aus2.3 This Standard may be applied ~~by for-profit entities, but not by not-for-profit entities,~~ to annual reporting periods

beginning on or after 1 January 2005 but before 1 January 2013. ~~If a for-profit entity~~ an entity applies this Standard to such an annual reporting period, ...

Amendment to AASB 12

- 10 Paragraph Aus4.3 is amended as follows (new text is underlined and deleted text is struck through):

Aus4.3 This Standard may be applied ~~by for-profit entities, but not by not-for-profit entities~~, to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2013. ~~If a for-profit entity~~ an entity applies this Standard to such an annual reporting period, ...

Amendment to AASB 127

- 11 Paragraph Aus1.3 is amended as follows (new text is underlined and deleted text is struck through):

Aus1.3 This Standard may be applied ~~by for-profit entities, but not by not-for-profit entities~~, to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2013. ~~If a for-profit entity~~ an entity applies this Standard to such an annual reporting period, ...

Amendment to AASB 128

- 12 Paragraph Aus1.3 is amended as follows (new text is underlined and deleted text is struck through):

Aus1.3 This Standard may be applied ~~by for-profit entities, but not by not-for-profit entities~~, to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2013. ~~If a for-profit entity~~ an entity applies this Standard to such an annual reporting period, ...

APPENDIX E

AUSTRALIAN IMPLEMENTATION GUIDANCE FOR NOT-FOR-PROFIT ENTITIES

This appendix is an integral part of AASB 10 and has the same authority as the other parts of the Standard. The appendix applies only to not-for-profit entities.

- IG1 AASB 10 incorporates International Financial Reporting Standard IFRS 10 *Consolidated Financial Statements*, issued by the International Accounting Standards Board. Consequently, the text of the body of this Standard and Appendices A–C is expressed from the perspective of for-profit entities in the private sector. The AASB has prepared this appendix to explain and illustrate how the principles in the Standard apply from the perspective of not-for-profit entities in the private and public sectors, particularly to address circumstances where a for-profit perspective does not readily translate to a not-for-profit perspective. The appendix does not apply to for-profit entities or affect their application of AASB 10.
[new paragraph, compared with the draft Appendix D (agenda paper 6.3) for the February 2012 AASB meeting]
- IG2 This appendix addresses a range of matters affecting not-for-profit entities broadly in the order in which the related paragraphs appear in the body of the Standard and in Appendix B. The appendix paragraphs are arranged under the same headings as in the body of the Standard or Appendix B. Cross-references to the paragraphs in the body of the Standard and to the other appendices are included to assist in relating the paragraphs in this appendix to the requirements of the Standard. A number of illustrative examples are also provided.
[new paragraph]

Control

- IG3 Paragraph 5 of AASB 10 sets out the fundamental requirement that an investor shall determine whether it controls an investee. As indicated by the reference in paragraph 11 to assessing power arising from contractual arrangements, **the investor need not have a financial investment in the investee.** In general terms, an investor and an investee are merely entities that have a relationship in which control of one entity (the investee) by the other (the investor) might arise.
[based on para IG1(a) in the draft Appendix D (agenda paper 6.3) for the February 2012 AASB meeting]

Power

- IG4 One of the criteria set out in paragraph 7 for control of an investee is that the investor has power over the investee. Paragraph 10 states that an investor has power over an investee when the investor has **existing rights** that give it the **current ability** to direct the relevant activities, ie the activities that significantly affect the investee's returns. As an example, a not-for-profit investor would have power over an investee when the investor can require the investee to deploy its assets or incur liabilities in a way that affects the returns to the investee (for example, in providing goods or services to the investor or other parties that assist in achieving or furthering the investee's objectives).
[based on the first part of para IG2 in the draft Appendix D (agenda paper 6.3) for the February 2012 AASB meeting]
- IG5 Paragraph 11 states that power arises from **rights**, and refers to **voting rights granted by equity instruments** and **rights arising from contractual arrangements**. For many not-for-profit entities, rights may also arise from **existing statutory arrangements**. As an example of contractual or statutory arrangements, a not-for-profit investor **normally** will have power over an investee that it has established when the constituting document or enabling legislation specifies **the operating and financing activities** that may be carried out by the investee. However, the impact of the constituting document or **legislation is evaluated in the light of other prevailing circumstances**, as all facts and circumstances need to be considered in assessing whether an investor has power over an investee. For example, a government may not have power over a research and development corporation that operates under a mandate created, and limited, by legislation if that or other legislation assigns power to direct the relevant activities to other entities that are not controlled by the government, such as participants in the research and development activities.
[based on para IG4 in the draft Appendix D (agenda paper 6.3) for the February 2012 AASB meeting]
- IG6 The research and development corporation example in the previous paragraph illustrates that an investor might not have power over an investee due to the rights of other parties in relation to the investee, as indicated in paragraph B10. As another example, subject to consideration of all the facts and circumstances, a State government normally would not have power to direct the relevant activities (ie the activities that significantly affect the returns) of a local government that determines through the council elected periodically by the local community how to deploy its resources in the interests of the local community (even though those interests might coincide with the

interests of the State government).
[based on para IG5 in the draft Appendix D (agenda paper 6.3) for the February 2012 AASB meeting]

Rights that give an investor power over an investee

IG7 Paragraph B15 provides examples of rights that, either individually or in combination, can give an investor power over an investee. In relation to not-for-profit investors, additional examples of such rights include:

- (a) rights to give policy directions to the governing body of an investee that give the holder the ability to direct the relevant activities of the investee; and
- (b) rights to approve or veto operating and capital budgets relating to the relevant activities of an investee.

[based on para IG6 in the draft Appendix D (agenda paper 6.3) for the February 2012 AASB meeting]

IG8 As a further example, a not-for-profit investor can have power over an investee even if it does not have responsibility for the day-to-day operation of the investee or the manner in which prescribed functions are performed by the investee. For example, legislation governing the establishment and operation of an independent statutory office (such as that of an auditor-general or the judiciary) sets out the broad parameters within which the office is required to operate, and results in the office operating in a manner consistent with the objectives set by parliament. Therefore, subject to other facts and circumstances, if the other control criteria are also satisfied, the independent statutory office would be consolidated into the whole of government general purpose financial statements.

[based on para IG7 in the draft Appendix D (agenda paper 6.3) for the February 2012 AASB meeting]

Implementation examples
<p>Example IG1</p> <p>A religious organisation establishes a community housing program that provides low-cost housing. The program is operated under an agreement with an incorporated association. The association's only activity is to manage the community housing facility. The association has no ownership instruments.</p> <p>The board of governors has 16 members, with eight appointed by</p>

(and subject to removal by) the religious organisation. By tradition, the chair is appointed by the board from amongst the appointees of the religious organisation, and has a casting vote that is rarely exercised.

The religious organisation owns the land on which the housing facilities stand and has contributed capital and operating funds to the association over the life of the facilities. The association owns the housing facilities.

The association retains any surplus resulting from the operation of the facilities and under its constitution is unable to provide a financial return to the religious organisation.

Example IG1A

Based on the facts and circumstances outlined above, the religious organisation controls the association. The religious organisation has rights that give it the current ability to direct the relevant activities of the association, regardless of whether the religious organisation chooses to exercise those rights.

The religious organisation also has rights to variable returns from its involvement with the association. Even though the religious organisation has never received (and cannot receive) a financial return, the religious organisation is receiving benefits through the association furthering its social objective of providing low-cost community housing. In addition, the religious organisation has the ability to use its powers over the composition of the board of governors of the association to affect the amount of its returns.

Example IG1B

In this example, the facts of Example IG1A apply, except that:

- the association's board of governors is elected through a public nomination and voting process that does not give power to the religious organisation to appoint board members; and
- decisions made by the association's board are reviewed by the religious organisation but it is unable to replace board members as a form of veto.

Based on the facts and circumstances outlined above, the religious organisation does not hold sufficient power over the association to direct its relevant activities and therefore does not control the association.

The religious organisation may still consider that it receives indirect, non-financial returns from the association in that the religious organisation's social objectives in relation to low-cost community housing are being furthered by the activities of the association. However, congruence of objectives alone is insufficient to conclude that one entity controls another (see paragraph IG18).

- IG9 Paragraph B19 lists a range of indicators that an investor has more than a passive interest in an investee, but notes that the existence of such indicators does not necessarily mean that the power criterion is met. The indicators listed include the investee's operations being dependent on the investor, such as dependence on the investor to fund a significant portion of its operations, guarantee a significant portion of its obligations or provide critical goods or services. Paragraph B40 also states that, in the absence of other rights, the economic dependence of an investee on the investor does not lead to the investor having power over the investee.

[new paragraph: replaces the first sentence of para IG12 in the draft Appendix D (agenda paper 6.3) for the February 2012 AASB meeting]

- IG10 An example of the circumstances contemplated in paragraphs B19 and B40 is that a government may not have the current ability to direct the relevant activities of entities (such as private schools, private hospitals, private aged-care providers and universities) that are financially dependent on government funding, where the governing bodies of those entities maintain discretion with respect to whether they will accept resources from the government, or the manner in which their resources are to be deployed. This may be so even if government grants provided to such entities require them to comply with specified conditions. While these entities might receive government grants for capital construction and operating costs subject to specified service standards or restrictions on user fees, their governing body may maintain ultimate discretion about how assets are deployed.

[based on the remainder of para IG12 in the draft Appendix D (agenda paper 6.3) for the February 2012 AASB meeting]

Substantive rights

- IG11 Barriers that prevent a holder of rights from exercising them are considered in determining whether the rights are substantive, that is, whether the holder has the practical ability to exercise the rights (paragraph B22). Paragraph B23 provides examples of barriers. For

some not-for-profit investors, political, cultural, social or similar types of barriers might make it difficult for the investor to exercise rights that they hold in relation to an investee. However, the investor's rights would be substantive, despite such barriers, if the investor can still choose to exercise those rights. For example, a government may have the power to appoint and remove the majority of members of the governing body of a railway authority but may be reluctant to remove members because of sensitivity in the electorate regarding the previous government's involvement in the operation of the rail network. In this case, the government has substantive rights, irrespective of whether it chooses to exercise them.

[based on para IG8 in the draft Appendix D (agenda paper 6.3) for the February 2012 AASB meeting]

- IG12 Paragraph B24 states that to be substantive, rights need to be exercisable when decisions about the direction of the relevant activities need to be made. Usually this means that the rights need to be currently exercisable, however paragraph B24 also notes that sometimes rights can be substantive even though they are not currently exercisable. For many not-for-profit investors, power over an investee may be obtained from existing statutory arrangements. Power to enact or change legislation and rights specified in substantively enacted legislation do not give the investor the current ability to direct relevant activities of the investee. Furthermore, depending on circumstances, statutory arrangements may be in the nature of protective rights rather than substantive rights – see the following paragraphs.

[based on para IG3 in the draft Appendix D (agenda paper 6.3) for the February 2012 AASB meeting]

Protective rights

- IG13 Protective rights are defined in Appendix A as rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate. Applying this principle to not-for-profit entities, protective rights include rights held by a government or other entity in order to protect, as distinct from enhance, the interests of the beneficiaries of an entity or the public at large. In accordance with paragraph B27, such rights do not result in the investor (the government or other entity) having power over an investee or restricting another entity from having power over the investee.

[based on para IG10 in the draft Appendix D (agenda paper 6.3) for the February 2012 AASB meeting]

- IG14 Not-for-profit entities might hold regulatory powers that restrict the way in which regulated entities operate. The regulatory powers may

be exercisable through an established framework within which entities are required to operate, including the ability to impose conditions or sanctions on their operations. Regulatory powers may represent protective rights, which do not give power over an investee, or substantive rights that need to be considered in determining control. Not-for-profit investors are required by paragraph B26 to assess whether their rights (and rights held by others) are protective or substantive rights.

[based on para IG9 in the draft Appendix D (agenda paper 6.3) for the February 2012 AASB meeting]

IG15 In addition to the examples in paragraph B28, examples of protective rights in relation to not-for-profit entities include:

- (a) the right of a regulator to curtail or close the operations of entities that are not complying with regulations or other requirements. For example, a pollution control authority may be able to close down activities of an entity that breach environmental regulations.
- (b) the right to remove members of the governing body of another entity under certain restricted circumstances. For example, a State government may be able to remove or suspend the councillors of a local government and appoint an administrator for reasons relating to a lack of probity.
- (c) the right of the government to remove tax deductibility for contributions to a not-for-profit entity if the entity significantly changes its objectives or activities.
- (d) a philanthropic trust providing resources to a charity on condition that the net assets of the charity would be distributed to a similar organisation undertaking similar activities if the charity is liquidated. (However, if the trust had the power to determine specifically to where the charity's net assets would be distributed upon liquidation, the trust would have substantive rights in relation to the charity.)

[based on para IG11 in the draft Appendix D (agenda paper 6.3) for the February 2012 AASB meeting]

Returns

Exposure, or rights, to variable returns from an investee

IG16 One of the criteria set out in paragraph 7 for control of an investee is that the investor has exposure, or rights, to variable returns from its involvement with the investee. The examples of returns in

paragraph B57, particularly those in paragraph B57(c), indicate that the scope of the nature of returns is broad. In application to not-for-profit entities, the broad scope of the nature of returns encompasses financial, non-financial, direct and indirect benefits, whether positive or negative, including the achievement or furtherance of the investor's objectives.

[based on para IG1(b) in the draft Appendix D (agenda paper 6.3) for the February 2012 AASB meeting]

- IG17 An investor's exposure, or rights, to variable returns from its involvement with an investee may give rise to indirect, non-financial returns, such as when achieving or furthering the objectives of the investee contributes to the objectives of the investor. For example, the provision of goods and services by the investee to its beneficiaries may affect the extent to which the investor's social policy objectives are furthered.

[based on para IG13 in the draft Appendix D (agenda paper 6.3) for the February 2012 AASB meeting]

Link between power and returns

- IG18 The third criterion set out in paragraph 7 for control of an investee is that the investor has the ability to use its power over the investee to affect the amount of the investor's returns. Therefore, the existence of congruent objectives alone is insufficient for a not-for-profit investor to conclude that it controls an investee. As an example, the investor would have the ability to use its power over the investee when it can direct the investee to work with the investor to further the investor's objectives.

[based on the last sentence of para IG2 and on para IG14 in the draft Appendix D (agenda paper 6.3) for the February 2012 AASB meeting]

Implementation example

Example IG2

A local government (Council) is created under a State's Local Government Act to operate for the peace, order and good government of its municipal district. The Council is administered by the councillors, who are elected directly by the local community in periodic elections. General requirements for the elections are set out in the Act.

Objectives of the Council

The Act specifies that the Council's primary objective is to achieve the best outcomes for the local community over the long term. In working to achieve this objective, the Council must have regard to:

- promoting the social, economic and environmental viability and sustainability of the municipal district;
- ensuring that resources are used efficiently and effectively and that services provided are accessible and equitable;
- the equitable imposition of rates and charges; and
- transparency and accountability in Council decision making.

Powers and Functions of the Council

The Council is empowered by the Act to do all things necessary and convenient for the achievement of its objectives and the performance of its functions, subject to any limitations under the Act or any other legislation (see the sections on the State Government's protective and substantive rights later in this example).

The Council's functions include:

- raising revenue to fund its functions and activities;
- planning for and providing services and facilities (including infrastructure) for the local community;
- strategic and land-use planning;
- making and enforcing local laws; and
- advocating proposals that are in the best interests of the district.

Activities and Returns of the Council

In carrying out its functions, the Council undertakes a wide range of activities, including the employment of staff, the imposition of rates and charges upon constituents, the establishment of policies and procedures, the purchase or sale of goods or services from or to constituents or other parties, transactions under financial contracts and prosecuting legal actions.

All of these activities contribute in some way (positive or negative) to the Council achieving or furthering its objectives. Thus they are activities that affect the returns of the Council, both in terms of

financial returns and non-financial returns.

State Government Involvement with the Council

The State Government's objectives for the government of the municipal district are consistent with the objectives of the Council, having set those out in legislation that it has enacted.

Consequently, the Council is subject to a wide range of State Government regulatory powers, even though its day-to-day operations are carried out by the Council's staff under the direction of its elected councillors. The State Government's rights in respect of the Council are held primarily by the Minister for Local Government, but other Ministers also hold some additional powers, such as land-use planning powers held by the Minister for Planning.

The interest of the State Government in the activities of the Council is to ensure that the general objectives set out in the Act are being achieved or furthered. To that end, the State Government has an extensive range of rights (through its Ministers) to advise or guide the Council in its activities or, at times, to intervene in the activities of the Council. The principal rights of the State Government are described in the following sections.

Protective rights of the State Government

Some of the State Government's rights are protective rights, as described in paragraph B26: rights that relate to fundamental changes to the activities of the Council (the investee) or that apply in exceptional circumstances. For example, the Minister has the following rights:

- restructure the Council through boundary changes or the abolition of the Council and the constitution of a new Council or Councils, with the Minister able to direct the transfer of property, income, assets, rights, liabilities, expenses and staff among Councils as part of the process;
- appoint inspectors of municipal administration or other inquiries to examine any Council matter and make recommendations to the Council, and enforce those recommendations if the Council does not adopt them;
- veto local laws passed by the Council where the laws substantially restrict competition without appropriate justification in the Minister's opinion; and
- suspend all the councillors of the Council if the Minister is

satisfied that there has been a serious failure to provide good government or serious unlawful acts by the Council – in which case an administrator is appointed to act as the Council and to perform its functions, powers and duties.

Substantive rights of the State Government

The State Government also has many rights that do not or may not fall into the category of protective rights, depending on their significance. They are substantive rights if they do not relate to fundamental changes or exceptional circumstances. For example, Ministers have the following rights:

- make guidelines concerning the Council's procurement policy or the provision of services by the Council so as to best meet the needs of the local community;
- review the allowance category annually for the Council, including the limits and ranges of councillor allowances;
- approve (or veto) investment by the Council in types of financial instruments not already approved under the Act;
- approve (or veto) Council entering into an entrepreneurial endeavour that exceeds 5% of the Council's revenue from rates and charges;
- give directions concerning rates and charges so as to limit the Council's general income for a financial year; and
- prepare a planning scheme for the district or authorise an amendment subject to any conditions that the Minister wishes to impose.

Control of the Council

Based on the facts and circumstances outlined above, does the State Government control the Council in accordance with the definition of control in the Standard? If not, who controls the Council?

Power

The State Government has numerous rights in relation to the Council. Whereas the protective rights do not provide power that could give the State Government control over the Council, the substantive rights do give the State Government the current ability to direct certain activities of the Council.

However, paragraph 10 of the Standard states that an investor has

power over an investee when the investor has the current ability to direct the *relevant activities*, ie the activities that *significantly affect* the investee's returns. Paragraph B10 also states that whether an investor has power depends on, for example, the rights the investor and other parties have in relation to the investee.

Although the State Government can direct certain activities of the Council, it is unable to direct the activities that *significantly affect* the Council's returns. Therefore, the State Government does not hold power over the Council as described in the Standard. The power to direct the relevant activities is held by the councillors of the Council, who direct, within the framework established by the State Government, the preponderance of the Council's activities that affect the returns from its operations.

To illustrate, if the Minister had approved the Council entering into an entrepreneurial endeavour that provides revenue equal to 15% of the revenue from rates and charges, that means that the Council has itself directed activities that provide over 85% of the Council's total revenue. Even if the Minister gives directions to limit the Council's rates and charges, that direction has only a marginal effect – it does not mean that the Minister directs the raising of all of the rates and charges. Furthermore, the Council still determines how the total rates and charges are to be divided across different categories of constituents, such as residential, industrial and farming ratepayers, or across different areas of the district. That allocation can contribute significantly to the Council's objectives, which are a key part of the returns of the Council.

Returns

The State Government is exposed, or has rights, to variable returns from its involvement with the Council since the activities of the Council contribute to the achievement or furtherance of the State Government's objectives for the good government and appropriate development of the municipal district.

Ability to use power to affect returns

The State Government has the current ability to affect the returns of the Council and thus its own indirect returns, through exercising its substantive rights. For example, the Minister can issue guidelines to improve the responsiveness of the Council's services to the needs of the community or can approve Council investment in different types of financial instruments. However, since it was concluded above that in the circumstances presented the State Government does not have power over the Council, then the third

control criterion linking power and returns is also not satisfied.

Control conclusion

The conclusion from the above assessment is that the State Government does not have power over the Council and therefore does not control the Council.

Indeed, there is no investor that controls the Council. The councillors as a group are not investors as contemplated by the Standard. They are akin to the board of directors of a company, that is, the councillors are a part of the Council itself. In this case, the Council would not be consolidated by any other entity.

Alternative Outcome

The distinction between protective and substantive rights and the significance of the substantive rights to the returns of the Council are matters for judgement in view of all the facts and circumstances in any particular situation. A different classification or assessment of the substantive rights to that presented in this example might change the conclusion on control of the Council.

Implementation example

Example IG3

XYZ University was established under an Act of the State. The University receives approximately 40% of its total revenue in the form of grants for various purposes, comprising 30% from the Australian Government and 10% from the State Government. The University is required by the Act to submit an annual report to the State Minister for Education.

Objectives of the University

The Act specifies that the University's objects include:

- to provide higher education at an international standard;
- to undertake scholarship and research to the advancement of knowledge and the benefit of the well-being of the Victorian, Australian and international communities;
- to equip graduates to excel in their careers and contribute to the

life of the community; and

- to serve the Victorian, Australian and international communities and the public interest by enriching cultural and community life and promoting critical and free inquiry and public debate.

Management of the University

The governing body of the University is the Council of the University. The Council consists of 17 members, five of whom are appointed directly or indirectly by the Minister. Four members are elected by the staff and students of the University. The remaining eight members are appointed by the Council itself, comprising the three official members (the Chancellor, the Vice-Chancellor and the president of the academic board) and five other (non-official) members.

The number of Minister-appointed members must be the same as the number of non-official Council-appointed members

The Council's responsibilities, powers and functions include:

- approving the mission, strategic direction and annual budget and business plan of the University;
- establishing policies ("university statutes and regulations") relating to the governance and operation of the University, including trusts and endowments, and research, development, consultancy, commercial activities and other services undertaken for commercial organisations or public bodies;
- developing guidelines (if any) concerning the carrying out of commercial activities, finance and property matters, or any other related matter;
- overseeing the management of the property, finances and business affairs of the University, such as risk management across the University, including its commercial activities;
- any other powers and functions conferred on it by or under legislation or any university statute or regulation; and
- the power to do anything else necessary or convenient to be done for or in connection with its powers and functions.

Activities and Returns of the University

In carrying out its functions, the University undertakes a wide range of activities, including employing academic, teaching and

administrative staff, determining fees and charges for courses provided to students and for commercial activities, entering into contracts, and forming or becoming a member of other entities.

All of these activities contribute in some way (positive or negative) to the University achieving or furthering its objectives. Thus they are activities that affect the returns of the Council, both in terms of financial returns and non-financial returns.

State Government Involvement with the University

The State Government's objectives for the activities of the University are consistent with those specified in the Act for the University. The Minister has the following powers and functions, which would generally be classified as substantive rights under the Standard, since they do not relate to fundamental changes to the activities of the University (the investee) or apply in exceptional circumstances:

- fix the remuneration and fees to be paid to Council members who are not full-time staff of the University or holders of statutory office;
- approve (or veto) University statutes and guidelines made by the Council;
- declare an activity to be a university commercial activity;
- make interim guidelines concerning university commercial activities and finance and property matters – these apply unless replaced by University-submitted guidelines approved by the Minister;
- in conjunction with the State Treasurer, approve the limits and conditions (e.g. security) for University borrowings;
- request commercial and financial reports from the University;
- refer a university commercial activity or any aspect thereof to the auditor-general for investigation and report to the Minister; and
- approve (or veto) the disposal of land that was previously Crown land granted to the University.

The Minister also has whatever rights are specified in government grants provided to the University. These rights might provide the ability to determine how the grants are applied or to require their repayment if not applied as specified.

Australian Government Involvement with the University

The Australian Government's objectives for the activities of the University are consistent with those specified in the State Act for the University.

The Australian Minister for Education also has whatever rights are specified in government grants provided to the University. The Minister can also request reports from the University.

Control of the University

Based on the facts and circumstances outlined above, does the State Government control the University in accordance with the definition of control in the Standard? If not, who controls the University?

Power

The State and Australian Governments have a range of rights in relation to the University. The University may be economically dependent on the grants from those Governments in order to carry out its activities at its present scope and scale, but paragraphs B19 and B40 of the Standard make clear that economic dependence does not lead to the investor having power over the investee.

The State Government has a range of substantive rights in relation to the operation of the University – principally in relation to its commercial activities or business operations rather than its teaching and research activities.

Judgement is required to conclude whether the State Government has the current ability to direct the University's *relevant activities*, ie the activities that most significantly affect the University's returns. As the returns are both financial and non-financial, current ability to direct the commercial activities and the education/research activities are both important. It is the Council that directs the latter activities and generally the commercial activities as well except to the extent of the Minister's rights. On balance, the Council would appear to have the current ability to direct the relevant activities, and thus the State Government would not have power over the University.

Returns

The State Government is exposed, or has rights, to variable returns from its involvement with the University since the activities of the

University contribute to the achievement or furtherance of the State Government's objectives for higher education.

Ability to use power to affect returns

The State Government has the current ability to affect the returns of the University and thus its own indirect returns, through exercising its substantive rights. However, since it was concluded above that in the circumstances presented the State Government does not have power over the Council, then the third control criterion linking power and returns is also not satisfied.

Control conclusion

The conclusion from the above assessment is that neither the State Government nor the Australian Government has power over the University and therefore neither Government controls the University.

Indeed, there is no investor that controls the University. The Council as a group is not an investor as contemplated by the Standard. It is akin to the board of directors of a company, that is, the Council is a part of the University itself. In this case, the University would not be consolidated by any other entity.

Alternative Outcome

The significance of the State Government's substantive rights to the financial (and non-financial) returns of the University are matters for judgement in view of all the facts and circumstances in any particular situation. A different assessment of the substantive rights or the weighting of financial and non-financial returns to that presented in this example might change the conclusion on control of the University.

Delegated power

IG19 An investor with decision-making rights (a decision maker) is required by paragraph B58 to determine whether it is a principal or an agent. Paragraphs B60 and B61 summarise factors to be taken into account in making that determination, such as the scope of the decision-making authority and the rights of other parties. The following examples illustrate these paragraphs in relation to not-for-profit entities:

- (a) a charity establishes a trust to fund the construction of dams in a developing country. The trustee's relationship with the trust does not extend beyond the normal responsibilities of a trustee, including making decisions about the financing and operating activities of the trust in accordance with the trust deed. If the charity can replace the trustee at its discretion, the trustee is an agent of the charity. In this case, the charity needs to assess whether it controls the trust given that, for example, the charity would be exposed, or have rights, to variable returns in terms of the extent to which its overseas aid objectives are achieved or furthered through the activities of the trust; and
- (b) a government department might act in relation to an investee only as an agent of the responsible Minister (in which case the department's activities in relation to the investee would be reflected in its reporting under AASB 1050 *Administered Items*) or else as a principal in its own right. In the latter case, the department would report its activities in relation to the investee as its own transactions, and the investee would be consolidated by the department. The scope of the department's decision-making authority is a significant factor in distinguishing whether it is acting as an agent or as a principal.

[based on para IG15 in the draft Appendix D (agenda paper 6.3) for the February 2012 AASB meeting – but paragraph (b) replaced]

Implementation examples [not yet updated]
<p>Example IG4</p> <p>A statutory authority is established under State health services legislation to deliver services to the community. The statutory authority is responsible for its day-to-day operations and has a governing council that oversees its operations.</p> <p>The State Health Minister appoints the authority's governing council and, subject to the Minister's approval, the authority's governing council appoints the chief executive of the authority.</p> <p>The State Health Department acts as the "system manager" for the State public health system on behalf of the Minister. This role includes:</p> <ul style="list-style-type: none"> • strategic leadership, such as the development of State-wide

health service plans;

- directions for the delivery of health services, such as entering into service agreements, capital works approval and management of State-wide industrial relations, including employment terms and conditions for the authority's employees; and
- monitoring of performance (e.g. quality of health services and financial data) of the authority and taking remedial action when performance does not meet specified performance measures.

Although the Department holds decision-making authority in regard to the statutory authority, it requires the Minister's approval for the following decisions:

- entering into service agreements with the authority;
- issuing binding health service directives;
- development of State-wide health service plans and capital works management and planning; and
- employment and remuneration of executive staff.

In this role the Department is remunerated either explicitly for the services provided or through appropriations.

Example IG4A

Based on the facts and circumstances outlined above, the Department has delegated power over the statutory authority and is acting as an agent on behalf of the Minister. This is evident through the restricted decision-making authority held by the Department, the rights held by the Minister and the nature of the remuneration received by the Department for its role as a system manager. As a result, the statutory authority would be consolidated directly into the whole of government general purpose financial statements.

Example IG4B

The facts are the same as in Example IG4 with the exception that, in its role as system manager, the Department does not require the Minister's approval for its decisions and assessments of the Department's performance encompass the performance of the statutory authority.

In this example, the scope of the decision-making authority held by

the Department has increased so that the Department has the current ability to direct the relevant activities of the authority so as to achieve the health service objectives of the Department. Therefore, based on the facts and circumstances, the Department controls the statutory authority. The control held is considered delegated control from the Minister. The statutory authority would be consolidated into the whole of government financial statements as part of the Department's consolidated financial statements.

BASIS FOR CONCLUSIONS

This Basis for Conclusions accompanies, but is not part of, AASB 2012-X.

Background

- BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board's considerations in reaching the conclusions in the Exposure Draft. Individual Board members gave greater weight to some factors than to others.
- BC2 In the process of developing the proposals in this Exposure Draft, the Board commissioned research into the implementation issues that had been encountered by not-for-profit entities in applying the notion of control (and related public sector guidance) in the superseded Accounting Standard AASB 127 *Consolidated and Separate Financial Statements*. Discussions were also held with constituents experienced in not-for-profit public sector and private sector financial reporting, to ascertain implementation issues that might be encountered in applying AASB 10 *Consolidated Financial Statements* (which replaces AASB 127, in part) in a not-for-profit context. Based on the research findings and the nature of many of the issues identified, the Board concluded that the principles in AASB 10 could be applied in a not-for-profit context, albeit using professional judgement, and that certain aspects of those principles and the terminology adopted warranted specific implementation guidance for not-for-profit entities.
- BC3 In addition, the Board noted that some of the issues identified through the research are fundamental to the notion of control and therefore beyond the scope of AASB 10. These issues include:
- (a) the nature of government departments as reporting entities;
 - (b) the role that disclosure of disaggregated information in whole of government financial reports might play in providing relevant information to users; and
 - (c) control of assets.
- BC4 The Board concluded that, because they are beyond the scope of AASB 10 and would not impede the application of AASB 10 by not-for-profit entities, these issues do not need to be addressed prior to clarifying for not-for-profit entities the application of the notion of control in AASB 10. The Board noted that this approach is consistent with its policy of transaction neutrality. Accordingly, the Board

decided to progress its Control in the Not-for-Profit Public and Private Sectors project in stages. The first stage, of which this Exposure Draft is a part, is intended to clarify the application of AASB 10 in a not-for-profit context. Later stages will address the associated fundamental issues noted above.

- BC5 The remainder of this Basis for Conclusions outlines the basis for the Board's proposals relating to the first stage of the project.

Significant Issues

Nature and location of guidance

- BC6 The Board considered whether the implementation guidance to be added to AASB 10 should be integrated into the body of that Standard as Aus paragraphs. The Board decided that, in general, consistent with a principles-based approach to drafting Standards, Aus paragraphs in the body of the Standard should be limited to those that either amend the requirements in AASB 10 or add new requirements. As the proposed implementation guidance would not amend the requirements or add new requirements for not-for-profit entities, the Board decided that the proposed guidance should not be presented as Aus paragraphs within the body of AASB 10.
- BC7 The Board then considered whether the guidance should be presented as Aus paragraphs integrated within the existing Application Guidance (Appendix B to AASB 10) or as a separate attachment to AASB 10. As Appendix B is integral to AASB 10 and therefore has the same authority, Aus paragraphs in either the body of the Standard or Appendix B would have no difference in status. Accordingly, the Board applied the same approach as stated in the previous paragraph. The Board therefore decided to propose the addition of the not-for-profit implementation guidance to AASB 10 as a separate attachment.
- BC8 The separate attachment is proposed in this ED as Appendix E to AASB 10, integral to the Standard and thus with the same authority as the body of the Standard. The Board considered whether to propose the attachment as guidance that accompanies, but would not be part of, AASB 10. To facilitate the guidance being applied consistently by not-for-profit entities, the Board decided that the ED should propose the addition of an appendix integral to AASB 10.

Terminology

- BC9 As AASB 10 incorporates IFRS 10 *Consolidated Financial Statements*, issued by the International Accounting Standards Board

(IASB), the text of the body of AASB 10 and Appendices A–C is expressed from the perspective of for-profit entities in the private sector. The Board considered that some of the terminology in the Standard does not readily translate to a not-for-profit perspective and decided that it would be useful to explain that terminology for application in a not-for-profit context. The terms „investor“ and „investee“, for example, figure prominently in AASB 10, including in the definition of control, and are described in general terms in paragraph IG3. The nature of „returns“, for example, is also addressed in the proposed implementation guidance. The Board believes the explanations provided will assist a not-for-profit entity to better relate to and apply the requirements of AASB 10.

Control

BC10 ... text to be added ...

Power

BC11 ... text to be added ...

Returns

BC12 ... text to be added ...

Link between power and returns

BC13 ... text to be added ...

Other issues

BC14 ... no implementation guidance proposed in respect of de facto agents and control of specified assets ...

Early application by not-for-profit entities

BC15 ... removal of the prohibition on early application of AASB 10 and its accompanying Standards (AASB 11, AASB 12, AASB 127 and AASB 128) by not-for-profit entities ...