

Meeting: International Public Sector Accounting
Standards Board

Meeting Location: Toronto, Canada

Meeting Date: June 17–20, 2013

Agenda Item 3

For:

- ☐ Approval
☒ Discussion
☒ Information

Update of IPSASs 6–8

Objective(s) of Agenda Item

1. The objectives of this agenda item are to:
 - (a) **Decide** whether to include an exception from consolidation for investment entities in the ED based on IFRS 10, *Consolidated Financial Statements* (refer to agenda item 3.1);
 - (b) **Decide** whether to mandate the presentation of consolidated financial information by statistical sectors (at a whole-of-government level) and, in conjunction with this, make the presentation of consolidated financial statements optional (refer to agenda item 3.2);
 - (c) **Decide** how to proceed in developing an Exposure Draft (ED) based on IFRS 10, *Consolidated Financial Statements*, with regard to exceptions to consolidation. Staff are seeking decisions on exceptions to consolidation and how the Basis for Conclusions should summarise the IPSASB's debates (refer to this memo and agenda item 3.3); and
 - (d) **Provide an update** on related IASB projects that the IPSASB is monitoring (refer to the Appendix to this memo).

Material(s) Presented

Agenda Item 3.1	Issues Paper: Consolidation Exception for Investment Entities
Agenda Item 3.2	Issues Paper: Consolidation and Statistical Reporting
Agenda Item 3.3	Background Paper: Consolidation and User Needs

Background

2. The objective of this project is to develop IPSASs based on:
 - (a) IFRS 10, *Consolidated Financial Statements*;
 - (b) IFRS 11, *Joint Arrangements*;
 - (c) IFRS 12, *Disclosure of Interests in Other Entities*;
 - (d) IAS 27, *Separate Financial Statements* (Amended 2011); and
 - (e) IAS 28, *Investments in Associates and Joint Ventures* (Amended 2011).

June 2012

3. At its meeting in June 2012 the IPSASB noted the differences between current IPSASs and the new and revised IFRSs and gave directions on the approach to this project.

September 2012

4. At its meeting in September 2012 the IPSASB considered opportunities for closer alignment with statistical reporting and a draft of an ED based on IFRS 10, *Consolidated Financial Statements*. Amongst other matters the IPSASB agreed that it wanted more emphasis on the types of situations that commonly occur in the public sector and less emphasis on issues associated with voting rights.

December 2012

5. At its meeting in December 2012 the IPSASB considered three draft EDs based on IFRSs 10-12 and issues arising from the development of those EDs.
6. In relation to ED X, *Consolidated Financial Statements* the IPSASB considered whether there should continue to be an exemption for temporarily controlled entities. The IPSASB did not support keeping the current exception for temporarily controlled entities in IPSAS 6. The IPSASB also did not support making the temporary control exception more restrictive. The IPSASB agreed to consider further the possibility of removing the temporary control exception altogether or possibly requiring that temporarily controlled entities be equity accounted. The IPSASB also agreed to consider the possible application of equity accounting to various categories of controlled entities, including entities that have been rescued from financial distress and Government Business Enterprises.
7. In relation to structured entities the IPSASB noted that the structured entity definition and structured entity disclosures in ED X, *Disclosure of Interests in Other Entities* might need to be amended to be more appropriate in the public sector context.

March 2013

8. The agenda papers for March 2013 included all five EDs that comprise this project. The IPSASB provided detailed feedback on the following two EDs, and related issues:
 - (a) The ED based on IAS 27, *Separate Financial Statements* (Amended 2011); and
 - (b) The ED based on IAS 28, *Investments in Associates and Joint Ventures* (Amended 2011).
9. The IPSASB considered outstanding issues in respect of the three other EDs. The key outstanding issues were:
 - (a) Whether there should be any exceptions to the requirement to consolidate controlled entities. As part of this discussion the IPSASB considered a range of alternative measurement and presentation options, including the possibility of equity accounting for certain entities. The IPSASB did not conclude on this issue in March and it is the focus of all three issues papers comprising this agenda item. The key points from the March 2013 meeting are outlined in the draft minutes at agenda item 1; and
 - (b) How to appropriately limit the definition of structured entities in the public sector. The IPSASB agreed to limit the definition of structured entities so that it excludes some common types of arrangements in the public sector.

Task-Based Group

10. The Task-based Group (TBG) for this project comprises Adriana Tiron Tudor, Masud Muzaffar, Stefan Berger and Ken Warren. The TBG has had the opportunity to comment on draft papers, but the recommendations remain those of staff.

Order of Agenda Papers

11. The issue of whether there should be any exceptions to consolidation of all controlled entities is an extremely broad issue. At previous meetings the IPSASB has considered arguments for and against the consolidation/non-consolidation of:
- (a) Temporarily controlled entities;
 - (b) Entities rescued from financial distress; and
 - (c) Government Business Enterprises (GBEs).¹
12. As part of these discussions the IPSASB has noted the potential difficulties in operationalizing exemptions and the risk that such exemptions could lead to dissimilar accounting treatment for similar entities (both within and between governments). Despite the IPSASB acknowledging these difficulties, there continue to be concerns about the appropriateness of requiring consolidation of all controlled entities or the appropriateness of presenting consolidated financial statements that do not differentiate between various types of controlled entities.
13. At the March 2013 meeting two specific proposals were put forward for consideration. These proposals were in relation to an exception from consolidation for investment entities and reporting of statistical sectors as an alternative to requiring consolidation at a whole-of-government level. Although these two proposals are very specific, staff requests that the IPSASB debates the proposals in agenda papers 3.1 and 3.2 first, before moving onto a more general discussion of how to proceed in developing an ED on consolidated financial statements (at which stage the matters discussed in agenda paper 3.3 may be helpful). The reasons for considering these specific issues first are as follows:
- (a) Agenda paper 3.1 which focuses on investment entities also includes a number of general arguments put forward by those who oppose exceptions to consolidation and comments by those who generally support consolidation but who consider that investment entities represent a special case. The arguments outlined in this paper might be useful in a more general discussion. Agenda paper 3.1 recommends an exception from consolidation for investment entities;
 - (b) Agenda paper 3.2 considers a proposal to permit optional presentation of consolidated financial statements at a whole-of-government level (in conjunction with mandatory sector reporting). The distinction between entities that engage in market and nonmarket activities has some appeal as it is one way of identifying core government. However, as noted in agenda paper 3.3 the classification of entities into statistical sectors is not always clear cut

¹ As noted previously, the IPSASB is reviewing the definition of a GBE and its approach to identifying the scope of IPSASs. Given this review and the difficulty of establishing an accepted international definition it would be preferable not to establish specific requirements for GBEs in IPSASs.

and entities that one might consider to be similar in nature (because they have commercial objectives) could be classified differently depending upon the level of any subsidy provided. Agenda paper 3.2 recommends, amongst other things, that the IPSASB agree not to permit optional presentation of consolidated financial statements (in conjunction with mandatory sector reporting) at a whole of government level in the context of this project. It also recommends that the issue of whether IPSAS 22 should be mandatory should be considered in the project on *Alignment of IPSASs with Public Sector Statistical Reporting Guidance* (addressed in agenda item 10);

- (c) Having considered and made decisions on these two specific proposals, the IPSASB may be able to draw out some principles that assist it in considering whether there should be any further exceptions to consolidation.
- 14. Agenda paper 3.3 is a background paper. It provides information on ways in which public sector entities may be grouped and notes characteristics of entities and possible user needs associated with types of entities. This paper might be useful to the IPSASB in confirming where there is common agreement that consolidated financial statements are useful and where the benefits of consolidated financial statements are more contentious. It may also assist the IPSASB in considering whether it considers that an exception to consolidation for a specific group of entities can be justified on the grounds of user needs.
 - 15. Staff notes that there is currently little information about the needs of users of whole of government financial statements² or the usefulness of consolidated information in respect of differing types of controlled entities.
 - 16. Staff's proposal for making progress on this issue is to propose a rebuttable presumption that consolidation meets user needs and to depart from this requirement only where it is possible to justify that consolidation does not meet user needs. The recommendation to have an exception for investment entities (agenda paper 3.1) is an example of where it has been argued that consolidation does not meet user needs.
 - 17. In the context of considering any further exceptions from consolidation, staff requests that the IPSASB have regard to the general arguments regarding the benefits of consolidated financial statement in agenda paper 3.1 and the following comments.
 - (a) Consolidated financial statements provide a panoramic view of a government's activities and current financial position. This panoramic view ensures that users do not lose sight of the risks associated with certain sectors. It shows the performance of the government as a whole.
 - (b) Exceptions lead to rules-based standards.
 - (c) Consolidation of all controlled entities is an example of like items being accounted for in like ways. Exceptions to consolidation reduce the coherence of the financial statements.

² Fawcett, Gillian, April 2013, *Whole of Government Accounts: Is anyone actually paying attention?*

Previous Agenda Papers on Equity Accounting

18. Previous agenda papers (refer to agenda paper 7.1, March 2013) have considered the use of equity accounting for controlled entities. It presented some pros and cons of equity accounting having regard to the qualitative characteristics of information in general purpose financial reports. It also noted arguments that could be used to support equity accounting and fair value as possible alternatives to consolidation.
19. These arguments are not repeated in full here. Key points in support of equity accounting (as an alternative to consolidation) were:
 - (a) The ability to use equity accounting when investments are not publicly traded or when markets are illiquid.
 - (b) Equity accounting is likely to achieve the same net asset position and net surplus as would consolidation, but at a lower cost.
 - (c) To the extent that controlled entities measure assets and liabilities at fair value, fair value information would be captured in the surplus and net assets of the controlled entity and would be picked up by equity accounting.

Recommendations Regarding Exceptions to Consolidation

20. It is recommended that the IPSASB AGREE to proceed to develop an ED based on IFRS 10 that:
 - (a) Requires consolidation of all controlled entities other than investment entities; and
 - (b) Seeks the views of constituents as to whether there are any categories of entities that should not be consolidated, with a request that any proposals for non-consolidation be justified having regard to user needs.

Matter(s) for Consideration

1. Does the IPSASB agree with the above recommendations?

These recommendations should be considered following discussion of agenda papers 3.1 to 3.3.

Developing the Basis for Conclusions

21. The issue of exceptions to consolidation is the key issue delaying progress on this project. At this meeting staff is seeking direction on exceptions to consolidation. Because this has been a key issue and members have had a range of views, it will be important for the Basis for Conclusions to note the various approaches considered by the IPSASB, the arguments in support of and against those approaches and the IPSASB's conclusion in the ED.
22. The arguments for and against the two specific proposals considered in agenda items 3.1 and 3.2 are outlined in those agenda papers.
23. The arguments for against consolidation of other categories of controlled entities could be drawn from previous agenda papers and discussions at this meeting. However, it would be helpful if, at the conclusion of this item the IPSASB could confirm which types of controlled entities or proposals should be specifically discussed in the Basis for Conclusions on ED X, *Consolidated Financial*

Statements, and the key arguments supporting the IPSASB's decisions. The subheadings that could be used in drafting the Basis for Conclusions are:

- (a) Temporarily controlled entities;
- (b) Investment entities;
- (c) Entities rescued from financial distress (or entities where control has been obtained as a result of an intervention);
- (d) GBEs;
- (e) Optional presentation of consolidated financial statements at a whole-of-government level (in conjunction with mandatory sector reporting; and
- (f) Suitability of equity accounting for certain controlled entities.

Project Milestones and Next Meeting

24. The major project milestones (assuming that decisions on exceptions from consolidation are made at this meeting) are set out below.

Major Project Milestones	Timing
Discussion of issues	June 2012–June 2013
Approve EDs (4 month comment period proposed)	September 2013
Review of responses to EDs and development of IPSASs	March 2014–September 2014
Approve Final IPSASs	December 2014

Appendix

Related IASB Projects

The IPSASB has previously agreed to monitor certain IASB projects that could result in amendments to the IFRSs on which the IPSASs will be based. Some of these proposed amendments may be included in the IPSASB's EDs depending upon their stage of completion when the IPSASB issues its EDs. The projects, together with an update on recent developments, are listed in the table below.

Project	Update
ED/2012/3 <i>Equity Method: Share of Other Net Asset Changes</i>	<p>The IASB issued ED/2012/3 in November 2012 (comments were due by 22 March 2013). ED/2012/3 proposed to clarify how an investor should account for other net asset changes of the investee.</p> <p>The IASB has not yet discussed feedback from constituents. Final amendments are expected to be issued in Quarter 4, 2013 (source: IASB workplan as at 30 April 2013).</p> <p>The IPSASB has agreed to incorporate the amendments in ED/2012/3 in ED X, <i>Investments in Associates and Joint Ventures</i> to the extent that they are relevant. If the IASB's amendments have not been finalized when the IPSASB's EDs are issued (which appears likely), the IPSASB has agreed to seek constituents' views on those aspects of the ED. Staff will continue to monitor this project.</p>
Separate Financial Statements: equity method	<p>IAS 27, <i>Separate Financial Statements</i> does not currently permit the use of the equity method in separate financial statements.</p> <p>The IPSASB has agreed to reinstate the use of the equity method in separate financial statements and to monitor the IASB's project proposing to reinstate the equity method in IAS 27.</p> <p>In May 2013 the IASB tentatively decided to amend paragraph 10 of IAS 27, <i>Separate Financial Statements</i> to allow an entity to account for investments in subsidiaries, associates and joint ventures using the equity method in their separate financial statements. [Source: IASB staff update 23 May 2013]</p> <p>An ED is expected in Quarter 3, 2013 (source: IASB workplan as at 30 April 2013).</p> <p>The Basis for Conclusions in the IPSASB's ED will include a comment on the state of progress of the IASB's project.</p>
Equity method research project	<p>The IPSASB has previously agreed to monitor the IASB's research project on the usefulness of the equity method of accounting and, in the context of the liaison meetings with the IASB, to indicate the IPSASB's interest in this project.</p> <p>This project has not commenced (source: IASB project page, accessed 28 May 2013).</p>

ISSUES PAPER: CONSOLIDATION EXCEPTION FOR INVESTMENT ENTITIES

Objective(s) and Structure of the Paper

1. The objective of this issues paper is to assist the IPSASB in deciding whether to incorporate an exception from consolidation for investment entities in the ED based on IFRS 10 *Consolidated Financial Statements*.
2. The sections in this issues paper are:
 - (a) Background;
 - (b) Definition of an investment entity;
 - (c) Measurement and disclosure requirements;
 - (d) Arguments for and against an exception to consolidation for investment entities;
 - (e) Relevance of investment entity concept in the public sector;
 - (f) Recommendations; and
 - (g) Next steps.

Background

3. As shown by Table 1, the consolidation exemption for investment entities has a long history. Table 1, set out below, outlines the points at which the International Accounting Standards Board (IASB) considered matters leading to its recent decision to exempt investment entities from the consolidation requirements in IFRS 10. The Table includes a brief comment on IASB proposals or comments made by respondents. More detail is provided in the discussion following the Table.

Table 1: Background to Investment Entity Exemption

Date	Document(s)	Comment
May 2002	ED, <i>Improvements to International Accounting Standards</i>	This 2002 ED proposed revisions to IAS 27, <i>Consolidated and Separate Financial Statements</i> . It proposed to clarify that a subsidiary should not be excluded from consolidation simply because the entity is a venture capital organization, mutual fund, unit trust or similar entity.
September 2002	Comments on ED, <i>Improvements to International Accounting Standards</i>	Some respondents from the private equity industry disagreed with the proposed clarification.
December 2003	IAS 27, <i>Consolidated and Separate Financial Statements</i> (Revised 2003)	IAS 27 (Revised 2003) did not provide any exemptions for venture capital organizations etc. Arguments put forward by respondents and the IASB's response are discussed
December 2008	ED 10, <i>Consolidated Financial Statements</i>	ED 10 did not exempt investment entities from consolidation.

Date	Document(s)	Comment
March 2009	Comments on ED 10	Respondents to ED 10 queried the usefulness of consolidated financial statements for investment entities.
May 2011	IFRS 10, <i>Consolidated Financial Statements</i>	When the IASB issued IFRS 10 it did not contain any exemptions for investment entities. However, the IASB noted that it was still considering how an investment entity should account for its interests in subsidiaries, joint ventures and associates and what, if any, additional disclosures might be made about those interests.
August 2011	ED/2011/4, <i>Investment Entities</i>	The IASB sought feedback on a description of investment entities, an exception from consolidation for investment entities and disclosures on investment entities.
January 2012	Comments on ED/2011/4	
October 2012	<i>Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)</i>	There were some changes to the definition of an investment entity. The final definition has essential components (which must be present) and typical characteristics (which may not be present but whose absence must be explained).

Views Expressed to IASB in 2002-2003

4. In 2002 some respondents from the private equity industry argued that private equity entities should not be required to consolidate the investments they control in accordance with IAS 27. These constituents argued that fair value was more appropriate for those investments. Those respondents raised varying arguments—some based on whether control is exercised, some on the length of time that should be permitted before consolidation is required and some on whether consolidation was an appropriate basis for private equity entities or the types of investments they make.
5. The Basis for Conclusions on IAS 27 (Revised 2003) (paragraphs BC21 to BC27) set out the IASB's reasons for not accepting the arguments of respondents from the private equity industry. The reasons given by the IASB were:
 - (a) The issues raised were not specific to the private equity industry. The diversity of the investment portfolios of entities in the private equity industry is not different from the diversification of portfolios held by a conglomerate;
 - (b) A subsidiary should not be excluded from consolidation because of the nature of the controlling entity;
 - (c) Management intention should not be a determinant of control;
 - (d) It is not appropriate to differentiate between types of entity, or types of investment, when applying a control model of consolidation;
 - (e) Users' information needs are best served by financial statements in which investments under the control of venture capital organizations, private equity entities and similar organizations are consolidated, thus revealing the extent of the operations of the entities they control;

- (f) Information about different types of products and services and different geographical areas is relevant to users. Although this information may not be available in a consolidated balance sheet it can be provided by way of segment information;
- (g) Reporting fair value alone would preclude a user from being able to assess the financial position, results and cash flows of a group. For example, a large subsidiary might have a high level of debt and therefore a low fair value; and
- (h) A parent has the choice of disclosing fair value information [in respect of an investment] in the notes or of presenting separate financial statements which show the investment at cost or fair value.

Views Expressed to IASB in 2011-2012

6. The IASB's rationale for undertaking its project on investment entities is explained in the Basis for Conclusions on IFRS 10 (as amended in 2012) as follows:

Extract from Basis for Conclusions on IFRS 10

- BC217 Respondents to ED 10 questioned the usefulness of financial statements of investment entities that consolidate investees that the investment entity controls. They pointed out that some national accounting requirements, including United States Generally Accepted Accounting Principles (US GAAP), have historically provided industry-specific guidance that requires investment entities to measure all of their investments, including those that they control, at fair value. The respondents argued that an investment entity holds investments for the sole purpose of capital appreciation, investment income (such as dividends or interest), or both. Users of the financial statements of these investment entities told the IASB that the fair value of the investments and an understanding of how the investment entity measures the fair value of its investment is the most useful information.
- BC218 Furthermore, respondents to ED 10 argued that consolidated financial statements of an investment entity may hinder users' ability to assess an investment entity's financial position and results because it emphasises the financial position, operations and cash flows of the investee rather than those of the investment entity. Often, an investment entity holds non-controlling interests in some entities that are reported at fair value, as well as controlling interests in other entities that are consolidated in accordance with IFRSs. Reporting investments on more than one basis hinders comparability within the financial statements because all investments are held by an investment entity for a similar purpose – returns from capital appreciation, investment income, or both. In addition, some of the items consolidated may be measured at historical cost, which distorts the performance assessment of the investment entity and does not reflect the way in which the business of the entity is managed.
- BC219 Respondents to ED 10 also argued that when an investment entity consolidates the entities that it controls, it is not required to provide the disclosures related to fair value measurements that would be required if the subsidiaries were measured at fair value. For example, IFRS 7 *Financial Instruments: Disclosures* relates only to recognised financial assets and liabilities. There is no requirement to provide disclosures related to fair value for investments in consolidated subsidiaries. Information about fair value and the methodology and inputs used for determining fair value is vital for users to make investment decisions about investment entities. Investors in an investment entity are interested in the fair value of their interest in that entity and often transact with it on a fair value basis (ie their investment in the investment entity is based on a share of the net assets of that entity). Reporting the fair value of substantially all of the net assets of an investment entity allows the investors of that entity to more easily identify the value of their share of those net assets.

Definition of an Investment Entity

7. Although IFRS 10 defines an investment entity, the definition is reasonably permissive, in that it allows for the possibility that an investment entity might have only one investment, or might have only one investor. Relevant extracts from IFRS 10 are set out below. The extracts include:
- (a) The definition;
 - (b) Paragraph 27, which effectively repeats the definition; and
 - (c) Paragraph 28, which identifies the typical characteristics of an investment entity and identifies the related application guidance.

Extracts from IFRS 10

Definition of an investment entity

An entity that:

- (a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
- (b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and
- (c) measures and evaluates the performance of substantially all of its investments on a fair value basis.

27 A parent shall determine whether it is an investment entity. An investment entity is an entity that:

- (a) **obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;**
- (b) **commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and**
- (c) **measures and evaluates the performance of substantially all of its investments on a fair value basis.**

Paragraphs B85A–B85M provide related application guidance.

28 In assessing whether it meets the definition described in paragraph 27, an entity shall consider whether it has the following typical characteristics of an investment entity:

- (a) it has more than one investment (see paragraphs B85O–B85P);
- (b) it has more than one investor (see paragraphs B85Q–B85S);
- (c) it has investors that are not related parties of the entity (see paragraphs B85T–B85U); and
- (d) it has ownership interests in the form of equity or similar interests (see paragraphs B85V–B85W).

The absence of any of these typical characteristics does not necessarily disqualify an entity from being classified as an investment entity. An investment entity that does not have all of these typical characteristics provides additional disclosure required by paragraph 9A of IFRS 12 *Disclosure of Interests in Other Entities*.

8. IFRS 10, paragraph 27, refers to the application guidance set out in IFRS 10 paragraphs B85A to B85M. One of the requirements set out in the application guidance is that an investment entity shall have an exit strategy documenting how the entity plans to realize capital appreciation from substantially all of its equity investments and non-financial asset investments (IFRS 10, paragraphs B85F to B85H).
9. IFRS 10, paragraph 28, sets out four typical characteristics of investment entities. Although these characteristics would seem to exclude many public sector pension funds and sovereign wealth funds, they do not necessarily disqualify an entity from being classified as an investment entity. IFRS 10 contains guidance that would be relevant for public sector entities considering whether they are investment entities, despite not having all of the typical characteristics of an investment

entity. Table 2 gives examples of such guidance from IFRS 10, and the Basis for Conclusions on IFRS 10.

Table 2 Typical Characteristics of Investment Entities

Typical Characteristic	Extracts from IFRS 10 that would be relevant for public sector entities considering whether they meet the IASB definition of an investment entity
More than one investment	–
More than one investor	<p>B85R Alternatively, an investment entity may be formed by, or for, a single investor that represents or supports the interests of a wider group of investors (eg a pension fund, government investment fund or family trust).</p> <p>BC232 The Board agreed with respondents who stated that some of the proposed criteria were too strict and would inappropriately exclude some structures from qualifying as investment entities. The Board believes that there are structures in practice in which an entity does not meet one or more of the criteria that were described in the Investment Entities ED, but should still qualify as an investment entity. For example, the Investment Entities ED required an investment entity to have more than one investor; the Board thinks that some pension funds, sovereign wealth funds, and other investment funds with a single investor should qualify as investment entities. Moreover, respondents commented that the application guidance in the Investment Entities ED provided too many exceptions to the strict criteria.</p> <p>BC259 The presence of more than one investor was originally proposed as a requirement in the Investment Entities ED. However, respondents provided many examples of investment funds with a single investor. These included funds that temporarily have a single investor, government-owned investment funds, funds wholly owned by pension plans and endowments, and funds set up by an investment manager for an unrelated single investor with a unique investment strategy.</p> <p>BC260 The Board [IASB] does not think that there is a conceptual reason why an investment fund with a single investor should be disqualified from being an investment entity. However, the Board [IASB] thinks that having more than one investor would make it less likely that the entity, or other members of the group that contains the entity, would obtain benefits other than capital appreciation or investment income from its investment. Consequently, the Board [IASB] decided to include the presence of more than one investor as a typical characteristic of an investment entity rather than as part of the definition of an investment entity.</p>
Investors are not related parties	<p>B85U However, an entity may still qualify as an investment entity even though its investors are related to the entity. For example, an investment entity may set up a separate 'parallel' fund for a group of its employees (such as key management personnel) or other related party investor(s), which mirrors the investments of the entity's main investment fund. This 'parallel' fund may qualify as an investment entity even though all of its investors are related parties.</p>
Ownership interests in the form of equity or similar interests	<p>BC264 However, the Board believes that this form of ownership interests in an entity should not be the deciding factor as to whether it is an investment entity. Respondents provided examples of entities that do not have units of ownership in the form of equity or similar interests but provide investors with</p>

Typical Characteristic	Extracts from IFRS 10 that would be relevant for public sector entities considering whether they meet the IASB definition of an investment entity
	a proportionate share of their net assets. For example, a pension fund or sovereign wealth fund with a single direct investor may have beneficiaries that are entitled to the net assets of the investment fund, but do not have ownership units. In addition, respondents noted that funds with different share classes or funds in which investors have discretion to invest in individual assets would be disqualified from investment entity status because they did not provide each investor with a proportionate share of net assets.

10. The IASB has identified types of entities that might meet the definition of an investment entity (IFRS 10 paragraphs BC298 to BC300). They are:
 - (a) Private equity or venture capital funds;
 - (b) Master-feeder or fund-of-funds structures where an investment entity parent has controlling interests in investment entity subsidiaries;
 - (c) Some pension funds and sovereign wealth funds; and
 - (d) Other types of entities such as mutual funds and other regulated investment funds. However, these entities were considered to be less likely to hold controlling investments in other entities.
11. In all cases the entities would have to have a controlling interest in other entities for the investment entity exemption to be relevant.

Measurement and Disclosure Requirements

Financial Statements of an Investment Entity

12. Table 3 describes the IFRSs requirements for the financial statements of investment entities. The accounting requirements depend upon whether an investment entity has any “service” subsidiaries. A service subsidiary is an entity that provides services that relate to the investment entity’s investment activities.

Table 3 Financial Statements of an Investment Entity

Type of financial statements	No service subsidiaries	One or more service subsidiaries
Consolidated financial statements	<p><i>Consolidated financial statements are not presented.</i></p> <p>An investment entity that is required to apply the IFRS 10 exception to consolidation for all of its subsidiaries does not present consolidated financial statements.</p> <p>IAS 27, paragraph 8A</p>	<p><i>Consolidate any service subsidiaries.</i></p> <p>Measure other subsidiaries at fair value through profit or loss in accordance with IFRS 9, <i>Financial Instruments</i> (or, where an entity has not adopted IFRS 9, in accordance with IAS 39, <i>Financial Instruments: Recognition and Measurement</i>).</p> <p>IFRS 10, paragraph 31</p>
Separate financial statements	<p><i>Separate financial statements are the only statements required.</i></p> <p>A parent that is required (by IFRS 10) to measure its investment in an investment entity subsidiary at fair value through profit or loss shall account for that investment in the same way in its separate financial statements.</p> <p>IAS 27, paragraph 11A</p>	<p>Measure service subsidiaries at cost or at fair value in accordance with IFRS 9.</p> <p>Measure other subsidiaries at fair value through profit or loss.</p> <p>IAS 27, paragraphs 10 and 11A</p>

13. Investment entities are required to comply with certain disclosures in IFRS 12 (IFRS 12, paragraphs 19A to 19G). These disclosure requirements are set out below.

14.

<p>Extracts from IFRS 12</p> <p>Investment entity status</p> <p>9A When a parent determines that it is an investment entity in accordance with paragraph 27 of IFRS 10, the investment entity shall disclose information about significant judgements and assumptions it has made in determining that it is an investment entity. If the investment entity does not have one or more of the typical characteristics of an investment entity (see paragraph 28 of IFRS 10), it shall disclose its reasons for concluding that it is nevertheless an investment entity.</p> <p>9B When an entity becomes, or ceases to be, an investment entity, it shall disclose the change of investment entity status and the reasons for the change. In addition, an entity that becomes an investment entity shall disclose the effect of the change of status on the financial statements for the period presented, including:</p> <p>(a) the total fair value, as of the date of change of status, of the subsidiaries that cease to be consolidated;</p> <p>(b) the total gain or loss, if any, calculated in accordance with paragraph B101 of IFRS 10; and</p> <p>(c) the line item(s) in profit or loss in which the gain or loss is recognised (if not presented separately).</p> <p>Interests in unconsolidated subsidiaries (investment entities)</p> <p>19A An investment entity that, in accordance with IFRS 10, is required to apply the exception to consolidation and instead account for its investment in a subsidiary at fair value through profit or loss shall disclose that fact.</p> <p>19B For each unconsolidated subsidiary, an investment entity shall disclose:</p>

- (a) the subsidiary's name;
 - (b) the principal place of business (and country of incorporation if different from the principal place of business) of the subsidiary; and
 - (c) the proportion of ownership interest held by the investment entity and, if different, the proportion of voting rights held.
- 19C If an investment entity is the parent of another investment entity, the parent shall also provide the disclosures in 19B(a)–(c) for investments that are controlled by its investment entity subsidiary. The disclosure may be provided by including, in the financial statements of the parent, the financial statements of the subsidiary (or subsidiaries) that contain the above information.
- 19D An investment entity shall disclose:
- (a) the nature and extent of any significant restrictions (e.g. resulting from borrowing arrangements, regulatory requirements or contractual arrangements) on the ability of an unconsolidated subsidiary to transfer funds to the investment entity in the form of cash dividends or to repay loans or advances made to the unconsolidated subsidiary by the investment entity; and
 - (b) any current commitments or intentions to provide financial or other support to an unconsolidated subsidiary, including commitments or intentions to assist the subsidiary in obtaining financial support.
- 19E If, during the reporting period, an investment entity or any of its subsidiaries has, without having a contractual obligation to do so, provided financial or other support to an unconsolidated subsidiary (eg purchasing assets of, or instruments issued by, the subsidiary or assisting the subsidiary in obtaining financial support), the entity shall disclose:
- (a) the type and amount of support provided to each unconsolidated subsidiary; and
 - (b) the reasons for providing the support.
- 19F An investment entity shall disclose the terms of any contractual arrangements that could require the entity or its unconsolidated subsidiaries to provide financial support to an unconsolidated, controlled, structured entity, including events or circumstances that could expose the reporting entity to a loss (eg liquidity arrangements or credit rating triggers associated with obligations to purchase assets of the structured entity or to provide financial support).
- 19G If during the reporting period an investment entity or any of its unconsolidated subsidiaries has, without having a contractual obligation to do so, provided financial or other support to an unconsolidated, structured entity that the investment entity did not control, and if that provision of support resulted in the investment entity controlling the structured entity, the investment entity shall disclose an explanation of the relevant factors in reaching the decision to provide that support.

15. Investment entities are also be required to make the disclosures already contained in other Standards. In particular, the disclosure requirements in IFRS 7, *Financial Instruments: Disclosures*, IFRS 13, *Fair Value Measurement* and IAS 24, *Related Party Disclosures* would be likely to be relevant for users of investment entity financial statements.

Financial Statements of a Parent of an Investment Entity

16. The exception to consolidation is available only to the investment entity itself (IFRS 10, paragraph 33). The exception to consolidation is not available to the parent of an investment entity, unless the parent is also an investment entity. Therefore the parent of an investment entity (that is not itself an investment entity) prepares consolidated financial statements in which it consolidates all its controlled subsidiaries.
17. A number of respondents to the IASB expressed the view that the consolidation exception should also be available to the investment entity's controlling entity. The IASB did not agree. Its reasons for

continuing to limit the exception to an investment entity are set out in the Basis for Conclusions paragraph BC278.

Extract from Basis for Conclusions on IFRS 10

BC278 The Board has decided to provide an exception to consolidation because of the unique business model of investment entities. Non-investment entities do not have this unique business model; they have other substantial activities besides investing, or do not manage substantially all of their assets on a fair value basis. Consequently, the argument for a fair value measurement requirement is weakened at a non-investment entity level.

Comments on the IASB's Investment Entity Proposals

18. Appendix 1 to this memo sets out a selection of comments from the submissions received by the IASB when it sought feedback on its investment entity proposals in ED/2011/4. These comments are provided to give the IPSASB an idea of the nature of the arguments used in support of and in opposition to the proposals.
19. The main arguments supporting the proposals included:
 - (a) Fair value provides the most relevant and decision-useful information;
 - (b) Investors make their decisions based on the performance of the fund [investment entity], which is based on the change in fair value of the fund [investment entity] from one period to the next;
 - (c) The proposals reflect how investment entities are managed and enables users to evaluate how efficiently and effectively management has discharged its responsibilities for the entity's resources (the 'stewardship' aspect of the objective of financial reporting;
 - (d) Consolidation is appropriate where there is a parent-subsidary relationship but not where there is an investment entity–investee relationship; and
 - (e) Consolidation does not provide the most useful information to users of an investment entity's financial statements.
20. The main arguments made in opposition to the proposals included:
 - (a) The lack of a conceptual basis for departing from the principle of control;
 - (b) The creation of an industry-specific exception which represents a departure from the objective of focusing on the nature of transactions;
 - (c) The argument that fair value of the investment is the most useful information to users is questionable, given the requirement to consolidate when the ultimate parent is not an investment entity;
 - (d) The concept of control is fundamental to determining the boundaries of a reporting entity and the preparation and presentation of financial statements; and
 - (e) Concerns about opportunities for structuring that would reduce comparability.
21. Some of those opposing the proposals suggest that the fair value information needed by users could be provided via disclosure of the relevant information rather than by creating an exception to the general principle of consolidation.

22. The following views from respondents on ED/2011/4 are provided to explain, in more detail, the key points made by respondents. The first three respondents supported the proposals and the second three opposed them.
23. Comments from respondents supporting the IASB's investment entity proposals in ED/2011/4:
- (a) The respondent noted that the proposals in ED/2011/4 were inconsistent with the concept of control which is fundamental to the preparation and presentation of financial statements. However, the Conceptual Framework also explains that the objective of general purpose financial reporting is to provide decision-useful financial information. Therefore, on balance, the respondent supported the exception provided in the [draft] IFRS. The respondent's concerns around the inconsistency with the control concept were outweighed by the fact that the proposed exception offers investment entities the opportunity to provide more decision-useful information to the users of their financial statements. The Conceptual Framework does not provide a hierarchy of the different aspects of financial reporting addressed. The respondent noted that existing guidance in the IASB Conceptual Framework did not help them form a conclusive view as to whether the control concept or the concept of decision-useful information should prevail. (respondent CL156)
 - (b) This respondent noted that investors in an investment entity will expect the fund manager to account for its stewardship of the contributions made to the investment entity and the evolution of the value of those contributions. The investor will be interested to know the financial results of the investment entity and how those results have been achieved; that is, how the contributions have been deployed, the amount of risk taken and whether these have remained consistent with the investment strategy. It is therefore essential the financial results reflect the changes in fair value of the investment entity's holdings, regardless of whether any of those holdings qualify as affiliates, associates or joint ventures. It is also essential that the financial instruments disclosures are relevant to the economic decisions of the investor rather than the fund manager (Respondents CL121 and CL30). The following extracts are from respondent CL121:
 - (i) "Investment entities are a special type of vehicle that exist solely for the purpose of allowing investors to pool their contributions in order to receive benefits in proportion to their contributions from the investment of those contributions in accordance with a defined investment strategy. Investors realise their share of the benefits in the form of a return of their contributions together with a proportionate share of any capital appreciation, investment income, or both. Therefore the most useful information to enable investors to understand the performance of their investment is the change in its fair value."
 - (ii) "An advantage of collective investment is that it allows investors to access the services of professional fund managers and to achieve a level of risk diversification that would otherwise be unattainable. In selecting a particular investment vehicle an investor accepts a level of risk, which is understood prior to the contribution being made through access to regulatory documentation such as a prospectus or other pre-investment literature. The role of the fund manager is to execute the agreed investment strategy with a view to maximizing the fair value of the investments within the established risk parameters. The fund manager manages the portfolio of investments and evaluates its performance on a fair value basis."

- (iii) “In order to understand the significance of the fund manager’s investment decisions, investors need to be able to compare the fair value of investments measured on a consistent basis regardless of whether the investee meets the definition of a controlled entity in IFRS 10 or qualifies as an associate or joint venture. Consolidation of some investments does not allow a consistent comparison across all of the investments held by the entity.”
 - (c) A respondent noted that the IASB could have required consolidation of all controlled entities, but required fair value disclosures for certain entities. The respondent did not consider that this option was feasible because the costs would be greater than the benefits. The respondent considered that this approach would constitute a strong disadvantage for IFRS preparers and users compared to other jurisdictions where fair value accounting treatment is allowed, as well as to the detriment of global comparability of financial statements (respondent CL101).
24. Comments from respondents opposing the IASB’s investment entity proposals in ED/2011/4:
- (a) The respondent understood the IASB’s reasons for proposing this exposure draft, and agreed that for ‘investment entities’ users often find fair value information on controlled investments more useful than information on a consolidated basis. As ‘decision-usefulness’ is one of the key objectives of financial reporting, this was a persuasive argument. However, as shown in the following quotes, the respondent had a number of concerns, both in relation to the specific proposals and the implications for financial reporting more widely:
 - (i) “Financial reporting should be principles-based and exceptions from these principles should be extremely rare.”
 - (ii) “Creating a departure from the principle of consolidation risks creating a precedent for further departures from the conceptual framework to be sought.”
 - (iii) “If ‘decision-usefulness’ is considered to be capable of overriding the key principles of the conceptual framework, there is a risk to the overall quality and credibility of IFRS. If new requirements and departures from principles are justified purely because the resulting information is ‘decision-useful’, financial reporting will become internally inconsistent, less comparable and more voluminous.”
 - (iv) “The proposals in this exposure draft are rules-based and we doubt whether they will be workable. They provide structuring opportunities and will result in similar investments being accounted for differently depending on which side of the rules an entity falls.”
 - (v) “We believe the proposals should be based on the nature of the investment i.e. the purpose for which an investment is held, rather than on the type of investor, and should be principles-based. This is in line with the measurement of financial instruments which is based on business purpose.” (respondent CL113)
 - (b) Respondent CL160 was not convinced that industry-specific requirements and exceptions should be used in IFRS. Also, the respondent considered that the concept of control is fundamental in financial reporting. The respondent considered that consolidated accounts should reflect the group as one single entity, as if all assets and liabilities were directly controlled. However, the respondent acknowledged the potential user needs and the desire to present financial information as far as possible in line with the reporting entity’s business model. In that case it could be argued that the business model should as a general principle

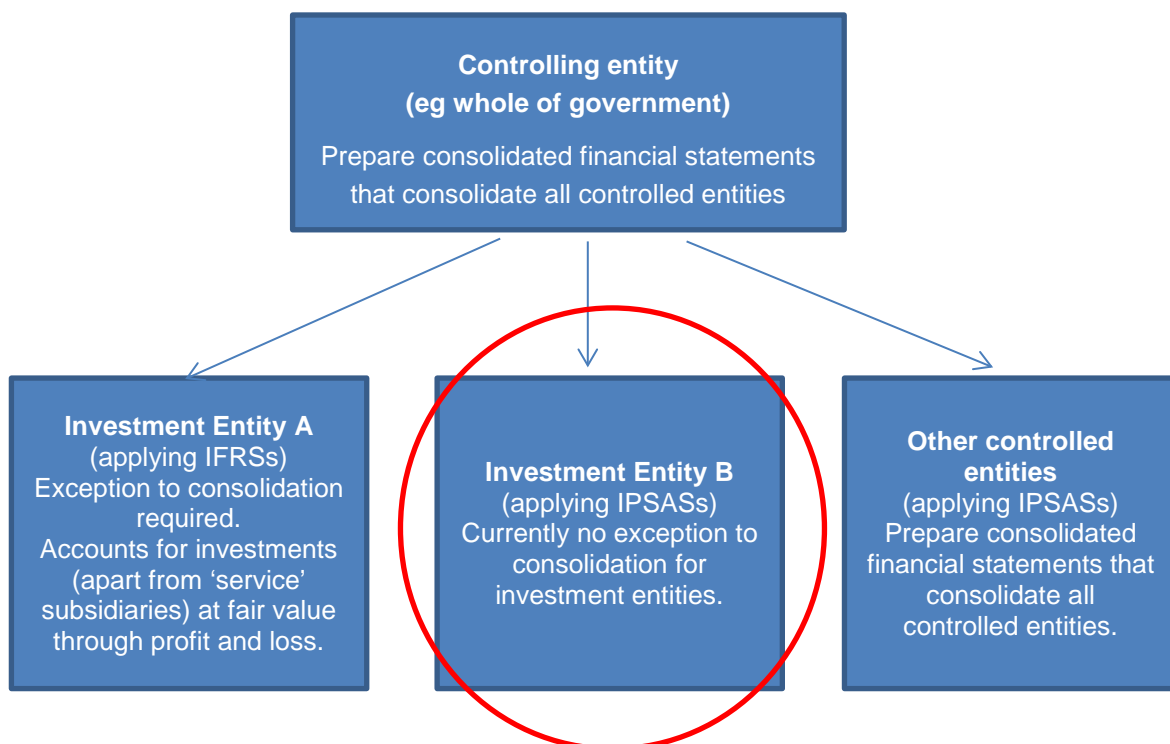
have precedence in IFRS similar to the management approach in IFRS 8. The respondent believed that there are several other situations where exceptions to IFRS might be needed to better reflect the business model and provide more useful information to users. The respondent was concerned that the proposed exception would impose an introduction to exceptions to fundamental concepts and policies within accounting. The respondent considered that comprehensive research and field studies were needed before deciding on industry specific or similar exceptions (respondent CL60).

- (c) Respondent CL67 noted that fair value accounting and consolidation offer different perspectives on how subsidiaries affect a parent entity's financial performance and position. Both perspectives provide useful information. It is therefore simplistic to argue that consolidation is 'right' for some parent entities, and fair value accounting for others, as a point of principle. The respondent suggested instead a pragmatic assessment of which type of information is most beneficial to users in practice, and also the associated costs of the two accounting methods. The respondent considered that consolidation should remain a fundamental building block of IFRS, as information on controlled investees' underlying financial position and performance is usually very relevant to users of a group's financial statements. Consolidation should therefore continue to be very much the 'norm', with fair value accounting available as an alternative only where the balance of evidence is that this is significantly more useful. That said, the respondent believed fair value accounting could be significantly more useful for certain categories of entities.The respondent considered that if constituents informed the IASB that fair value information is significantly more useful for the analysis of a certain class of entities, the IASB should be guided by users' views (respondent CL37).

Relevance of Investment Entity Concept in the Public Sector

- 25. This section considers the implications of including an exception from consolidation of investment entities in an IPSAS based on IFRS 10.
- 26. Diagram 1 (see below) shows that:
 - (a) The exception would have no impact at the whole of government level or on public sector entities that deliver services. Governments would not meet the definition of an investment entity.
 - (b) A public sector investment entity that is subject to jurisdictional requirements to report in accordance with IFRSs (see Investment Entity A in Diagram 1) would be required to apply the exception to consolidation in IFRS 10.
 - (c) A public sector investment entity that is subject to jurisdictional requirements to report in accordance with IPSASs (see Investment Entity B in Diagram 1) does not have access to an exception to consolidation for investment entities in current IPSASs. The question is whether such an exception should be included in the ED currently being developed. Such an exception would substantially change the requirements for these entities and would result in a cost saving at this level.

Diagram 1: Requirements Applicable to Public Sector Reporting Entities



Would Public Sector Investment Entities Apply IFRSs or IPSASs?

27. The IPSASB develops IPSASs for public sector entities other than Government Business Enterprises (GBEs). However, the standard setters or regulators in a jurisdiction determine which standards particular entities in that jurisdiction must apply. Therefore investment entities could potentially be required to apply IPSASs, IFRSs, or national standards.¹

Entities that Might Meet the Definition of an Investment Entity

28. Public sector entities that might meet the definition of an investment entity include: (i) sovereign wealth funds, (ii) pension funds and public pension reserve funds (iii) feeder funds and master funds and (iv) funds which hold controlling interests in public-private partnerships or (PPP) or public finance initiatives (PFI) projects. A brief description of these entities follows.
- (a) A sovereign wealth fund (SWF) is a state-owned investment fund composed of financial assets such as stocks, bonds, property, precious metals, or other financial instruments. Sovereign wealth funds invest globally.
 - (b) A pension fund is any plan, fund, or scheme which provides retirement income. The IASB refers (in IFRS 10) to the possibility of pension funds (including funds wholly owned by a

¹ A 2008 report on sovereign wealth funds stated that some sovereign wealth funds refer to the preparation of their financial statements in line with IPSASs. *Sovereign Wealth Funds, Current Institutional And Operational Practices*, Prepared by the IWG Secretariat In Collaboration With The Members of the IWG, September 15, 2008 <http://www.iwg-swf.org/pubs/eng/swfsurvey.pdf>

pension plan) being investment entities. It does not discuss whether a retirement benefit plan itself could be an investment entity although it appears that a defined contribution plan could meet the definition of an investment entity. In addition to having pension funds for employees, governments may also establish public pension reserve funds as a way of partly prefunding their otherwise pay-as-you-go (i.e. unfunded) financed social security systems. The main defining feature of public pension reserve funds, which differentiates them from pension funds, is that their ultimate beneficiaries (the general population) do not have legal or beneficial ownership over the reserve funds' assets. Rather, the legal or beneficial owner is the institution that administers the public pension system or the government. Public pension reserve funds may be set up and owned directly by government or owned by social security institutions.

- (c) A feeder fund is an investment fund which does almost all of its investments through a master fund via a master-feeder relationship. Investors invest in the feeder funds (and there may be separate feeder funds for different categories of investors), which in turn invest their assets in the master fund. The master fund makes all the portfolio investments and conducts trading activity. Both feeder funds and master funds can meet the definition of an investment entity. Although feeder funds and master funds do not appear to be prevalent in the public sector, they could occur.
 - (d) Some commentators have suggested that the IASB's investment entities amendment may affect some funds which hold controlling interests in public-private partnerships or (PPP) or public finance initiatives (PFI) projects.² Such funds may meet the definition of an investment entity if the purpose of the fund is solely to maximize returns for investors and it has no significant involvement in managing the construction, operational or maintenance activities of the underlying infrastructure projects. In order to meet the definition of an investment entity such funds would also need to have an exit strategy for the equity investment in the project (IFRS 10, paragraphs 27(b) and B85F to B85H). Although these funds will often be investing funds from the private sector, there could be instances of public sector funds.
29. In order to demonstrate that it is an investment entity, a fund would need to satisfy the definition of an investment entity and either meet all the typical characteristics of an investment entity, or explain why it is an investment entity, despite not having all the typical characteristics of an investment entity. In particular, it would need to:
- (a) Assess whether its mandate is consistent with the purpose of an investment entity (which is to invest funds solely for returns from capital appreciation, investment income, or both) (IFRS 10, paragraph 27(b)). Objectives that include developing, producing or marketing products would suggest that the entity's purpose includes earning returns from development, production or marketing activity and this would be inconsistent with the definition of an investment entity.
 - (b) Demonstrate that it has an exit strategy documenting how they plan to realize capital appreciation from substantially all of their equity investments and non-financial asset investments (IFRS 10, paragraphs 27(b) and B85F to B85H). The types of investments held by funds will vary widely depending on their specific objectives and mandates. However,

² Deloitte LLP, 2012, *Infrastructure Accounting Alert*, Accounting developments affecting funds which invest in PPP/PFI projects
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most funds will have some investments in equity or non-financial assets. Funds that are more focused on fiscal stabilization tend to have a higher weight on fixed income and cash while national saving funds and pension reserve funds are more likely to have a higher proportion of their portfolio in equity and more risky investment.³

- (c) Explain why it is an investment entity if it has only one investor (IFRS 10, paragraph 28(b)). Although sovereign wealth funds and pension funds could have more than one investor, in many cases there is a single investor (for example, a Minister or another public sector entity might hold all the ownership interest in the fund). A fund with only one investor could argue that it meets this characteristic in substance because it is investing the funds of citizens on behalf of the citizens. Indeed, IFRS 10, paragraph BC259 explicitly refers to government-owned investment funds and funds wholly owned by pension plans and endowments when explaining why the IASB decided to make this a typical characteristic rather than an essential part of the definition.
- (d) Explain why it is an investment entity if it has investors that are related parties (IFRS 10, paragraph 28(c)). The investor(s) in a sovereign wealth fund or public pension funds are likely to be related parties. A fund with a related party investor could argue that it meets this characteristic in substance because it is acting on behalf of many unrelated beneficiary investors.
- (e) Explain why it is an investment entity if it does not have ownership interests in the form of equity or similar interests (IFRS 10, paragraph 28(d)). Some sovereign wealth funds and public pension reserve funds do have ownership interests in the form of equity or similar interests, but others do not. Indeed, IFRS 10, paragraph BC264, specifically refers to pension funds and sovereign wealth funds when explaining why the IASB decided to make this a typical characteristic rather than an essential part of the definition. It said “For example, a pension fund or sovereign wealth fund with a single direct investor may have beneficiaries that are entitled to the net assets of the investment fund, but do not have ownership units.”

Implications for the IPSAS Based on IFRS 10

30. If the IPSAS based on IFRS 10 were to include an exception from consolidation for investment entities it:
- (a) Might apply to a relatively small number of entities. It would apply only to those public sector investment entities applying IPSASs. Public sector investment entities could be applying other standards, such as IFRSs;
 - (b) Might apply to entities such as sovereign wealth funds, pension funds and funds which hold controlling interests in PPP/PFI projects; and
 - (c) Would result in public sector investment entities reporting in accordance with IFRSs and IPSASs presenting similar financial statements.

³ OECD, February 2013, *The Role of Banks, Equity Markets and Institutional Investors in Long-Term Financing for Growth and Development*, Report for G20 Leaders

Appropriateness of IFRSs Requirements for IPSASs

31. If the IPSASB decides to incorporate an exception from consolidation for investment entities, it would need to consider the appropriateness of the requirements and guidance in IFRS 10 and IFRS 12 in the public sector context.
32. Changes that would be required to the text of IFRS 10 include:
 - (a) General terminology changes (for example replace 'parent' with 'controlling entity');
 - (b) IFRS 10 paragraph 27(b) requires that an investment entity "commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both". It is proposed to replace this reference to business purpose with a reference to the entity's mandate, both here, and throughout the ED;
 - (c) Keep the four typical characteristics of an investment entity in IFRS 10 but draft a Basis for Conclusions that acknowledges that in the public sector there may be investment entities with only one investor, with an investor that is a related party, and which do not have equity instruments;
 - (d) Redraft the discussion of ownership interests (IFRS 10, paragraphs B85V to B85W) to acknowledge that some public sector entities do not have explicit ownership instruments; and
 - (e) Ensure that the cross references to the requirements of other standards reflect the requirements in IPSASs. For example, the references to accounting for investments in associates would require that an entity has selected the fair value option rather than cost *or the equity method* (as proposed by the IPSASB). Also references to IFRS 3, *Business Combinations* would need to be removed as there is currently no equivalent IPSAS.
33. No significant changes would be required to the requirements of IFRS 12.

Recommendations

34. It is recommended that the IPSASB NOTE:
 - (a) That if the IPSAS based on IFRS 10 were to include an exception from consolidation for investment entities it:
 - (i) Might apply to a relatively small number of entities;
 - (ii) Might apply to funds such as sovereign wealth funds, pension funds and funds which hold controlling interests in PPP/PFI projects; and
 - (iii) Would result in public sector investment entities reporting in accordance with IFRSs and IPSASs presenting similar financial statements;
 - (b) The arguments made by respondents to the IASB for and against its proposals to create an exception from consolidation for investment entities;
 - (c) The IASB's exception from consolidation for investment entities applies only to an investment entity, not to its parent; and
 - (d) The IASB's exception from consolidation for investment entities is required – it is not an option.

35. It is recommended that the IPSASB AGREE that the IPSAS based on IFRS 10 should:
- (a) Include, a mandatory exception from consolidation for investment entities;
 - (b) Limit this exception from consolidation to the financial statements of the investment entity;
 - (c) Use the same definition and typical characteristics of an investment entity as in IFRS 10; and
 - (d) Include, in the Basis for Conclusions:
 - (i) An explanation of the types of entities that might be investment entities;
 - (ii) The view that the arguments for and against an exception from consolidation for investment entities are similar in the private and public sectors; and
 - (iii) The view that public sector investment entities should present similar financial statements regardless of whether they report in accordance with IFRSs or IPSASs.
36. It is recommended that the IPSASB AGREE that the IPSAS based on IFRS 12 should:
- (a) Require the same disclosures regarding investment entities as required by IFRS 12; and
Include, in the Basis for Conclusions, the view that the investment entity disclosures required by IFRS 12 are appropriate in the public sector context.

Matter(s) for Consideration

- | |
|--|
| 1. Does the IPSASB agree with the above recommendations? |
|--|

Next Steps

37. If the IPSASB agrees with these recommendations, the revised draft EDs including an exception from consolidation for investment entities, will be presented for approval at the IPSASB's September 2013 meeting.

APPENDIX Respondents' Comments to the IASB on ED/2011/4 *Investment Entities*

Respondents' comments to the IASB on Q1 of ED/2011/4 *Investment Entities*:

Do you agree that there is a class of entities, commonly thought of as an investment entity in nature, that should not consolidate controlled entities and instead measure them at fair value through profit or loss? Why or why not?

Arguments from those supporting the IASB's proposals included:

1. Fair value reporting provides the most relevant and decision useful information to investors. (The standard setter received many responses expressing this view). (CL136)
2. Better aligned with the entities' business model. (Many respondents including CL87, CL69, CL94, CL51, CL111, CL159 and majority of respondents within CL72).
3. Investment funds mark their investments to market and fair value information plus additional disclosure about portfolio composition should be sufficient for investors. (noted as an argument by CL1)
4. Investors and stakeholders want to review the performance of an investment entity by looking at movements in the fair value of portfolio companies. Investors are interested in investment income, capital gains and growth in the value of the portfolio. (CL104, CL130, CL147 similar)
5. Investors evaluate their investments based on fair value. When the investor's units are redeemed, the units are redeemed at fair value. Fair value provides users with the most meaningful information to evaluate the performance of their investments in such entities and to compare investment alternatives. (CL34)
6. Line by line consolidation for these entities would also obscure the user's ability to make appropriate decisions by emphasizing the assets and operations of the investee as opposed to the fair value of the investment. (CL34)
7. Consolidation would produce no additional useful information to users. In fact it would distort the actual performance and financial condition of the investment entity in term of its strength and its ability to support its investee companies, both of which are considered critical factors for an investment entity to succeed. (CL82)
8. If consolidation were required investment entities would need to prepare separate financial statements on a fair value basis. (respondent CL104)
9. A rating company expressed the view that consolidation of an entity's funds would have resulted in significant earnings fluctuations and financial statements that were "opaque". (quoted by CL104)
10. The proposed treatment best represents investment entities' business purpose, how they are managed and better meets the needs of users. (Many respondents CL20, and CL96)
11. For entities whose primary business purpose is to acquire investments for capital appreciation, current income, or both, value realisation occurs as a result of holding an investment, rather than from managing the underlying assets and liabilities of an investee. Investments held by such entities are like a portfolio of financial instruments held for trading by a financial institution, or investment property for capital appreciation, current income, or both. Whereas traditional operating entities invest in assets that they operate to generate profits (e.g. managing the activities of the

investee and its underlying assets to maximise cash flows of the consolidated entity). (CL68, CL89 similar)

12. Unitholders make their decision to invest in a pooled fund based on the performance of the fund, which, in turn, is based on the change in fair value of the fund from one period to the next. (CL62)
13. If controlled entities are consolidated and ownership percentages change from control to non-control, the financial statements will lack comparability between years. (CL62, similar comments in CL96 and CL161) As noted by another respondent consolidation requirements can reduce comparability between similar types of entities. (CL31)
14. Line by line consolidation is meaningless. (CL85).
15. Consolidation is appropriate when there is a parent-subsidary relationship. This is typically present when the parent integrates the operations of its subsidiaries into its own or, otherwise capitalizes on synergies between the operations of its subsidiaries and its own. ...When the parent subsidiary relationship is absent investments should be recorded at fair value. (CL48)
16. Some jurisdictions have regulatory requirements for investment entities to measure controlled entities at fair value through profit or loss. (CL154)
17. Users of financial statements of investment entities assess performance on a fair value basis and fair value measurement also provides the basis for the net asset values at which many investors enter and exit. (CL79, CL 45, CL169)
18. Investors realise their share of the benefits in the form of a return of their contributions together with a proportionate share of any capital appreciation, investment income, or both. Therefore the most useful information to enable investors to understand the performance of their investment is the change in its fair value. (CL116, CL38 similar)
19. The primary users of financial information are not necessarily institutional investors or money managers who are familiar with analysis techniques of consolidated statements. (respondent CL80)
20. Users are primarily interested in investment returns, rather than the operating performance of the investment (represented by equity accounting or consolidation). (CL91)
21. When an entity's primary objective is to obtain capital appreciation and/or investment income (such as dividends or income) rather than to obtain benefits through control, the information needs of users are not best met by the presentation of consolidated financial statements. Moreover, those investors are primarily interested in the fair value of those investments. Therefore, whilst the presentation of consolidated financial statements in those circumstances may faithfully represent acquired control, it will not satisfy the other principal qualitative characteristic of relevance. (CL14)
22. Consolidation would inappropriately emphasise the financial position, results and cash flows of the investee rather than those of the investment entity. (CL75)
23. Unlike trading companies, investment companies are not seeking to carry out part of their business activity through a controlled entity. The business of the investment entity can be irrelevant. (CL76)
24. Investors are primarily high net worth individuals or institutions that rigorously monitor performance through investment reports provided by the investment manager. Fair value and IRR are the important performance indicators. (CL2)

25. Support the proposal, but the exemption must be limited to entities that primarily manage their investments on a fair value basis and with pre-defined exit strategies. If this is not the business model, then consolidation should be required. (CL152)
26. Agree that fair value provides more decision-useful information about investments held for investment purposes and that are managed on a fair value basis than alternative measurement approaches. But the exemption should be available in respect of all entities with this business model – not investment entities. (CL71 and CL117)
27. The future economic benefit embodied in its assets (investments held by the investment entity) is the potential for capital appreciation, investment income (such as dividends or interest), or both and not to achieve operational synergies. The most useful information is the fair value of the investments and how the investment entity measures the fair value of its investments. (CL132, CL49 and others)
28. IEs are formed to provide investors with returns based upon the fair value of the IE's investments. Consolidated financial statements would impede an investor's ability to analyze this information because it distorts the financial position and results of operations of the IE. In addition, investors in an IE transact at Net Asset Value, which is based upon the investor's share of the net assets of the IE at fair value. Finally, it is industry practice (not required) under IFRS for entities that are IEs in nature, but which do not produce financial statements at fair value, to provide supplemental schedules that include fair value information (e.g., fair value of investments held and total return), underscoring investor reliance on fair value. (CL138)
29. More accurately reflects the commercial reality of the relationship. More closely aligned to the needs of investors and other stakeholders, many of whom have explained that consolidation at the level of underlying line items is of no practical use to them as they obtain value from the underlying components. Notes that investor mandated reporting typically requires the fair values of underlying investments rather than consolidated accounts. Consolidation by investment entities will usually be expensive, and in some cases, impracticable. (CL96)
30. Investors in investment entities focus on assessing the exit value of an ownership interest to decide whether to invest, hold or sell. Accordingly, financial statements that report investments held and the performance of investments on a fair value basis provide investors with the financial information they most want. (CL73, CL54, CL42)
31. A respondent highlighted that in the case of a typical investment entity, their investments are one of the most significant assets on the balance sheet and they should be appropriately measured and accounted for. (CL166)
32. The proposal reflects how investment entities are managed and enables users to evaluate management's performance based on the information that managers use, i.e., the proposal provides information that enables users to evaluate how efficiently and effectively the entity's management has discharged its responsibilities to use the entity's resources (the "stewardship" aspect of the objective of financial reporting). (CL73)
33. Consolidated financial statements would provide a combined position of all of the underlying assets and liabilities of the operating entities in which an investment entity has an indirect controlling interest. In the view of investors that we have consulted, information about the consolidated assets

- and liabilities of the operating entities would not assist them in evaluating the investing choices made by professional investment managers, nor the changes in value of their investment. (CL73)
34. Better comparability with other investments where the entity has a non-controlling interest. (CL134 and IASB ED para BC4)
35. The proposals will likely encourage the use of IFRS by the private equity community. Much of the private equity industry does not currently adopt IFRS due to the consolidation requirement. (CL92)
36. IAS 28 already provides a measurement exemption for investments in associates and joint ventures held by venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds. These entities can elect to measure their investments at fair value through profit and loss at the entity level. Therefore, the exception proposed in this ED is not entirely new. It is an extension of the recognised fact that fair value measurement is a more relevant measurement basis for investments held by entities meeting specific criteria such that the exemption is extended to controlled investees and is made mandatory. (CL95)
37. If the proposals proceed, the justification should be in terms of the business model approach in IFRS 9 *Financial Instruments*, rather than the control principles of IFRS 10. (CL112⁴, Minority view CL11)
38. Consolidation of investment entities could be expensive/inefficient when holdings can change significantly from time to time. (Minority view CL11)
39. Consolidation is expensive. Investment entities do not typically use this information. (CL48)
40. From a theoretical perspective, some may argue that how an investment is measured should be based on the nature of the investment rather than on the nature of the investor i.e., that in all instances those investments held for capital appreciation, investment income or both should be measured at fair value through profit or loss while those investments acquired for wider business purposes should be consolidated. The respondent has some sympathy for this viewpoint. However, the respondent feels that introducing an exemption at a transaction level rather than an entity level would present structuring opportunities. The respondent therefore pragmatically agrees that it is necessary to limit the exemption to investment entities. (CL103)
41. There is a clear distinction between listed investment entities, evaluated using fair value measurements, and other trading businesses, evaluated on metrics derived from consolidated financial statements. (CL44)
42. A respondent that supported the proposals qualified that support as follows. “We disagree that all entities in the class should be required to measure their direct investments at fair value ... because users of financial statements often express differing views about whether fair value is more useful. All investments ultimately have the purpose of, perhaps minor in some cases, capital appreciation, investment income or both. We agree fair value can provide more relevant information to many investors; however, investors taking a longer-term view of investments may be concerned with other information such as stable cash flows or earnings. (CL41)
43. The current consolidated financial results do not always give the financial information that investors seek from a company intending to hold an underlying investment for a short period of time. (CL41)

⁴ See also the key points from CL113.

Arguments from those opposing the IASB's proposals included:

1. Respondents supported the alternative view in the ED⁵, with one highlighting the arguments in paragraph AV7⁶ of the ED. (CL77, CL163, CL11, CL149 in part, CL108 in part).
2. The Basis for Conclusions on the ED does not establish a strong enough case for departure from the principle of consolidation. The arguments in the Basis for Conclusions are solely based on users' needs rather than reasoning from a conceptual basis. The ED is industry specific: it therefore represents a departure from the objective of focusing on the nature of transactions. The argument that the fair value of the investment is the most useful information to users is questionable (given the requirement to consolidate when the ultimate parent is not an investment entity). (CL11)
3. The respondent acknowledges the tension between user needs and conceptual reasoning, but (a majority) is of the view that both characteristics can be reasonably attained with appropriate additional disclosures. (CL11)
4. One respondent challenged the justification for the proposals. The main justification seems to be that some users of financial statements would find such information more useful to them. That may be so, but what about the users of financial statements that would prefer to understand what assets the entity controls, liabilities it is responsible for, the income it has earned and the expenses it has incurred? The information that the users to whom the IASB is listening is easily provided – either by additional fair value information in the notes to the consolidated financial statements, or by presenting parent-only financial statements in addition to the consolidated financial statements. In fact, entities are entitled to provide that information now. One wonders, if it is so useful, why this additional information is not already published as a matter of course by so-called investment entities. ... Although financial statements are prepared for the benefit of users, the respondent believes there is a great danger in just accepting that what they request should be required and setting standards on that basis. (CL6, Minority view in CL154 similar)
5. The ED does not establish a sound basis for the industry specific departure from the consolidation principle. (CL7, CL11, CL70, CL137, CL28, CL160)
6. The proposals lack any conceptual basis, indeed they are directly contrary to the concepts in the Framework... There are no principles upon which the proposals are based; rather they are a listing of detailed and artificial rules. Rules based standards are almost always susceptible to abuse through financial structuring and, in the respondent's view, a standard based on this ED would be particularly so. (CL6, CL98 similar)
7. Real estate assets owned by special purpose vehicles should be consolidated. Otherwise the financial statements of the fund may make no mention of real estate. Therefore investors have no insight into valuation methods and assumptions, rental income, average occupancy, operational

⁵ Alternate view: "...The concept of control is fundamental to the preparation and presentation of financial statements. The *Conceptual Framework* identifies control as an essential characteristic of an asset and, in turn, defines the other elements of the financial statements by reference to the definition of an asset. Although not articulated explicitly in the *Conceptual Framework*, the concept of control is, in effect, central to determining the boundaries of a reporting entity. This is reflected in the provisions of existing IFRSs: entities are required to recognise in their financial statements assets that they control directly and assets (and related claims) that they control indirectly by controlling other entities that in turn control those assets directly."

⁶ "...A controlling interest in another entity is not the same as a non-controlling interest in another entity, because the reporting entity has the power to direct the activities of the controlled entity for its benefit. Reporting requirements should reflect this difference."

results, cost efficiency, leverage, risk analysis and related party transactions. (CL1 and CL107 (in respect of real estate funds only))

8. The cost benefit analysis depends on which entities are permitted to use the exemption (respondent CL1). If it is limited to funds that collect funds from multiple investors and invest in multiple unrelated entities, the benefits of consolidated information are less.
9. Inconsistent with UK Framework which states “An entity controls another entity when it has the power to direct the activities of that other entity to generate benefits for (or limits to) itself. If an entity that controls one or more entities prepares financial reports, it should present financial statements. Consolidated financial statements are most likely to provide useful information to the greatest number of users.” (CL164)
10. Users of financial statements have the right to information about their entire investment portfolio which includes any subsidiaries – the respondent believes consolidated financial statements allow this. (CL164)
11. The concept of control is fundamental to determining the boundaries of a reporting entity and the preparation and presentation of financial statements and that financial reporting requirements should be principle-based and contain few, if any, exceptions. Respondent shares the alternate views of IASB members on the ED. (minority of CL72)
12. The exposure draft of the IASB’s conceptual framework chapter titled “The Reporting Entity” states that entities that control other entities should prepare consolidated financial reports. These concepts are fundamental to financial reporting. (CL6)
13. Comparability requires consistent application of methods – as discussed in the Framework. (CL39)
14. The respondent does not consider that there is a class of entities that are investment entities. The business model often carried out by what is thought of as investment entities is a general business model that is also carried out within entities commonly not thought of as investment entities. (CL137)
15. Consolidation provides an overall picture of investment entities’ resources and how they have been deployed and the relevant revenues and expenses they have generated. (CL39)
16. Concerns about opportunities for structuring which would reduce comparability. (Many comments including CL39, CL169, CL139, CL28)
17. The proposals are not consistent with the IASB’s long-standing practice of transaction-based standard setting. (Many respondents including CL7, CL39, CL6)
18. Comparability. Support for the dissenting views of IASB members. (CL15)
19. If there are exceptions [to consolidation], the criteria to be used must be robust and clear. The criteria presented in the draft are open to wide interpretation and to a certain extent unnecessary. (CL26)

Other comments to the IASB included the following:

1. For parent companies that are not investment entities, the cost saving of non-consolidation by an investment entity subsidiary will be lost under IFRSs because consolidation still will be required, just at a higher level. (CL153)

2. Measurement at fair value should be a choice and not a requirement. For example, an investment entity that is part of a wider group (that does not meet the investment entity criteria) may determine that the cost of preparing two reporting packs outweighs the benefits to investors. (CL16)
3. Some respondents suggested further outreach with financial statement users. (CL156)
4. A principles based approach would have been preferable to a list of mandatory criteria. (CL96, CL67, CL8, CL151, 140 and others)
5. Whether the consolidation of a controlled investment results in more decision-useful information than fair value measurement does not depend on the characteristics of the acquiring entity but on the characteristics of the investment, i.e. the purpose of the acquisition of a controlled entity. (CL8, CL99 was similar)
6. User needs may depend on the type of fund. The nature of the underlying investments may affect whether a user supports the proposals or not. For example, investors in property funds may be neutral regarding fair value vs. consolidation so long as there is adequate disclosure of the nature of the underlying property exposure in the non-consolidated entities. This is because the results on a fair value basis will be materially the same as a consolidated view as the majority of the net assets of the underlying entity would be held at fair value anyway. Investors in infrastructure funds are likely to have a preference for consolidation as this would reflect the amortised cost value of the underlying assets. This removes unwanted short term volatility under fair value and focuses on the intrinsic underlying value for the predominantly long-term investors. (CL139)
7. A fundamental concept or principle regarding the circumstances in which the fair value measurement provides more decision-useful information than consolidation should be developed. Specific criteria should be established based on that concept or principle. One suggested criterion was that the entity disposes of the investment within a foreseeable period. (CL90, CL109)
8. How often will an investment entity actually control an investee? (CL114)
9. The IASB should consider whether it is appropriate to account for fair value changes through the profit and loss account. (respondent CL114)
10. The exemption should also be available to the parent of an investment entity. (Many respondents including CL32)
11. Any supplementary information regarding leverage and the underlying risks/exposures to investments controlled by investment entities can be provided in the notes to the financial statements so as to provide users with any material supplementary information about underlying investments. (CL34)
12. Respondent did not support the IASB's proposals as they considered the proposal should apply to a broad range of investments. Where investments are acquired with the objective to achieve short-term disposal gains ("buy and sell strategy"), consolidation is not the most appropriate accounting. "To increase the decision-usefulness of consolidated financial statements, situations have to be avoided where the turnover of investments resulting in their consolidation and deconsolidation within a relatively short period of time leads to significant fluctuations in assets, liabilities and non-controlling interests." (CL57)
13. There should be a mixed model whereby entities are required to consolidate controlled entities which carry out non-investment business activity. (CL76)

14. Some who support consolidation might argue that the information needs of users could be met if supplemental fair value information were to be disclosed in a separate statement or notes or by preparing two sets of financial statements. The respondent considered that this would make the statements unnecessarily complicated and irrelevant. (CL63)
15. Investment entities are not a homogeneous population. Their business model may vary substantially. Consolidation should therefore remain an option for investment entities (e.g. for certain investment entities investing in real estate investment properties through intermediate entities). (CL94) Other took the opposite view and thought that, for comparability, the proposals should be mandatory for all investment entities. (CL155)
16. Our view is that most corporate property groups do not meet the criteria as defined in the ED, primarily because they operate just like any other normal corporate business and do not have an explicit commitment to invest for capital appreciation, investment income (e.g. dividends, interest) or an explicit exit strategy in the way that a typical investment entity would have. ...investors in corporate property groups require information on their underlying business activities and the performance of the company, employees, and management in operating the business. Users of these financial statements are interested in the separate reporting of rental revenue and rental expenses related to the real estate properties as key performance metrics, among others. A requirement to report investments at fair value through profit or loss and not consolidate the results, as proposed, would undermine the transparency of financial reporting that investors and users require. (CL123)
17. Some insurers wanted the proposals extended to also apply to insurers that invest in funds on behalf of policyholders. (CL97)
18. An exit strategy should be an additional criterion to qualify as an investment entity. (Many respondents)
19. The IASB should conduct a post implementation review to ensure that the provisions have not been inappropriately applied. (CL155, CL103)
20. There could be legal difficulties in applying the exemption in jurisdictions where the legislation requires that all controlled entities be consolidated. (CL149)

ISSUES PAPER: CONSOLIDATION AND STATISTICAL REPORTING

Objective(s) and Structure of the Paper

1. The objective of this issues paper is to assist the IPSASB in deciding whether to require the presentation of consolidated financial information by statistical sectors and whether such reporting should replace the current requirements for consolidation of all controlled entities.
2. The sections in this issues paper are:
 - (a) Background;
 - (b) IPSAS 22 and statistical reporting;
 - (c) Constituent's views on IPSAS 22 and alignment with GFS;
 - (d) Options for presenting information on statistical sectors in financial statements;
 - (e) Segment reporting and GFS;
 - (f) Basis for recommendations;
 - (g) Recommendations;
 - (h) Appendix 1: AASB 1049 Approach;
 - (i) Appendix 2: Consultation Paper – Responses to Specific Matter for Comment 5; and
 - (j) Appendix 3: Commonwealth Government of Australia – Approach to GFS Sector Disclosures.

Background

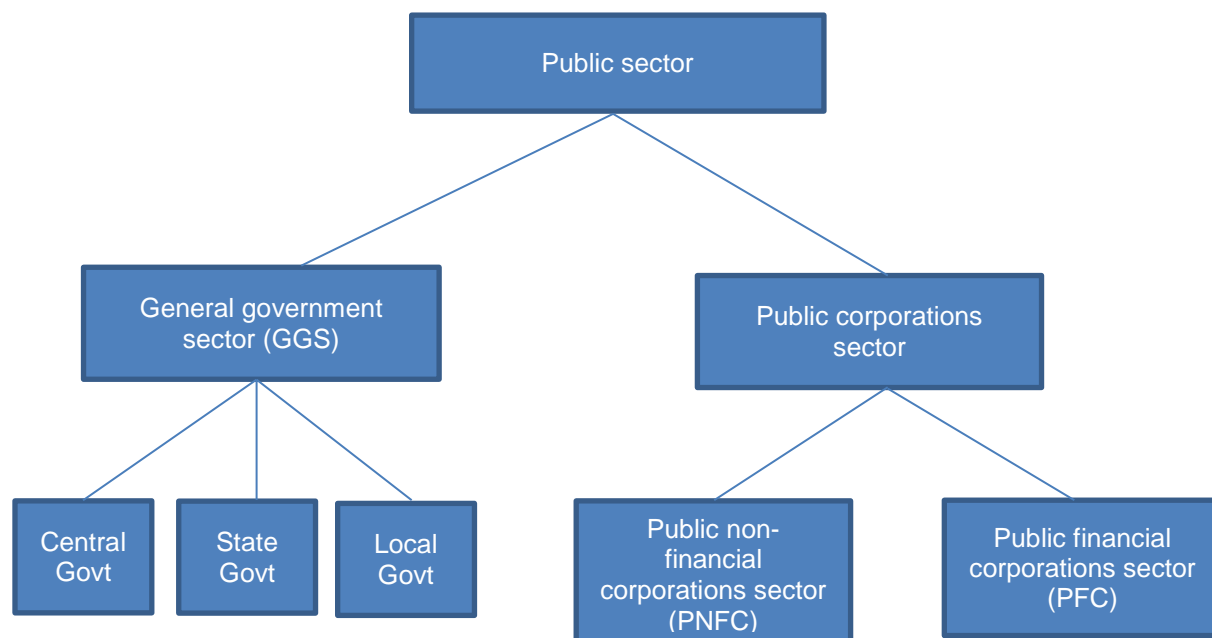
3. At the IPSASB's meeting in March 2013 some members proposed that the IPSASB consider options other than line-by-line consolidation of all controlled entities, including the separate presentation of consolidated financial information by function or by statistical sector. A member raised the possibility of requiring mandatory presentation of consolidated information on each key statistical sector, and optional consolidation across sectors (i.e., optional consolidation at a whole of government level). This proposal is considered in this issues paper, but only after noting the recent feedback received in relation to IPSAS 22 which is relevant to this issue.
4. The following requirements in current IPSASs are relevant:
 - (a) IPSAS 6, *Consolidated and Separate Financial Statements* requires line-by-line consolidation of all controlled entities;
 - (b) IPSAS 18, *Segment Reporting* requires entities to identify segments and present information about those segments; and
 - (c) IPSAS 22, *Disclosure of Financial Information about the General Government Sector* establishes presentation and disclosure requirements for consolidated financial statements when a government chooses to present financial information about the general government sector in those consolidated statements.

IPSAS 22 and Statistical Reporting

Statistical Reporting Sectors

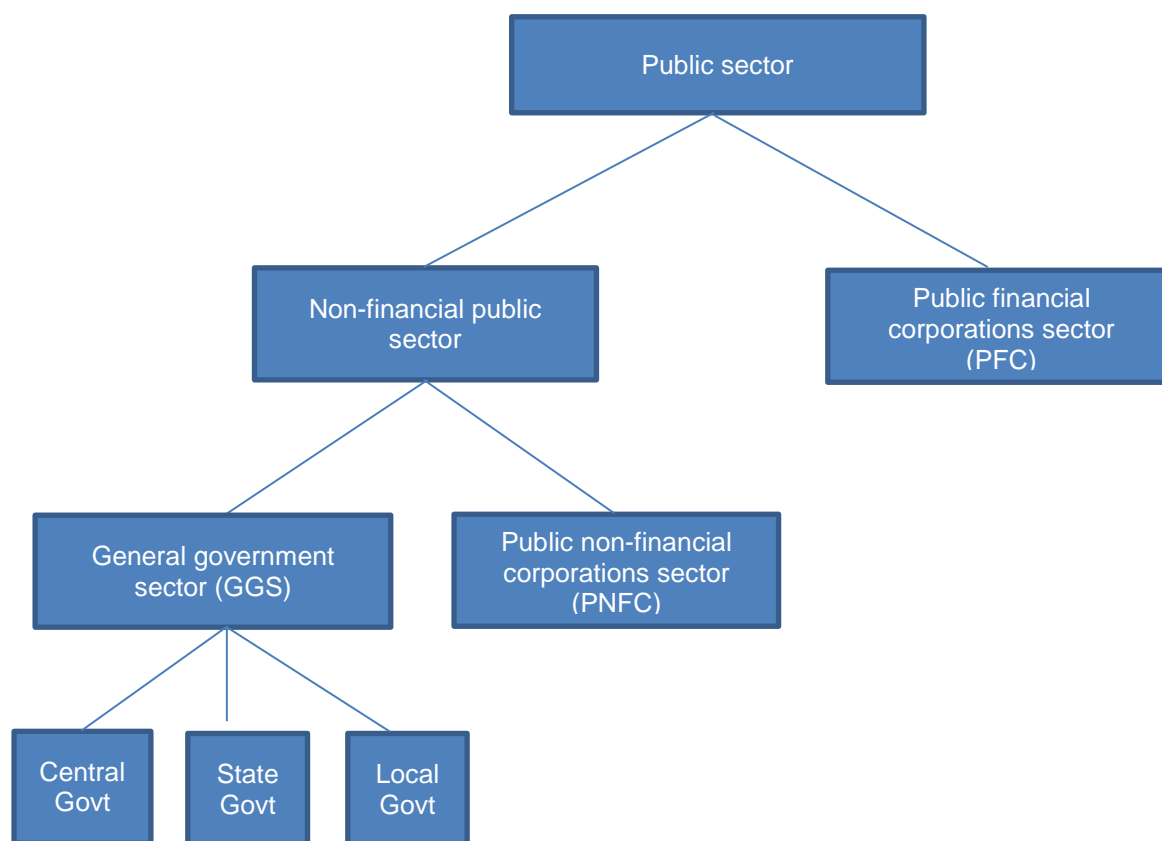
5. For statistical reporting purposes the public sector is divided into a number of components and information is presented in respect of each component. The main components of the public sector for statistical reporting purposes are set out in Figure 1 below. This paper does not discuss the treatment of social security funds which may be classified in different ways according to their nature and purpose.

Figure 1: Public Sector Components



6. The general government sector (GGS) is comprised of resident institutional units that, in addition to fulfilling their political responsibilities and their role of economic regulation, produce services (and possibly goods) for individual or collective consumption mainly on a non-market basis and redistribute income and wealth. Central government, state government and local government are subsectors of the general government sector.
7. Public non-financial corporations are resident institutional units that are principally engaged in the production of market goods and non-financial services.
8. Public financial corporations are resident institutional units that are principally engaged in financial services including financial intermediation (acting as the middleman between two parties in a financial transaction). This sector includes the central bank, deposit-taking corporations and other public financial corporations.
9. Sometimes a distinction is made between the financial and non-financial parts of the public sector, as shown in Figure 2.

Figure 2: Public Sector: Non-financial and Financial Sectors



Reasons for Issuing IPSAS 22

10. IPSAS 22 was issued in December 2006. The reasons for issuing IPSAS 22 are set out in the Basis for Conclusions on that standard which notes the following:
- (a) IPSASs (particularly IPSAS 6) require entities to present financial statements that include information about all the resources controlled by the reporting entity, and require the consolidation of all controlled entities.
 - (b) Both the *System of National Accounts 2008* and the *Government Finance Statistics Manual 2001* require governments to present financial information about the GGS (which is not the same as the reporting entity determined in accordance with IPSAS 6).¹
 - (c) The statistical community encouraged the IPSASB to develop an IPSAS addressing the presentation of GGS information as part of a government's consolidated financial statements as a means of facilitating convergence with statistical bases of accounting.
 - (d) The disclosure of GGS information can provide useful information to users of financial statements. This is particularly so when national or other governments publish financial

¹ The GFSM 2001 is currently being revised. A draft of the revised Manual, *Revision to Government Finance Statistics Manual 2001 (Draft Chapters)*, is available at <http://www.imf.org/external/np/sta/gfsm/index.htm>

statements in accordance with IPSASs and financial information in accordance with statistical bases of financial reporting.

- (e) The narrow scope of IPSAS 22 was intended to require the disclosure of GGS information only when the IPSASB considered that the benefits of doing would exceed the costs of preparing the information. At the time IPSAS 22 was issued the IPSASB was not convinced that all governments should be required to disclose GGS information in their financial statements.

Key Aspects of IPSAS 22

11. The key aspects of IPSAS 22 are as follows:

- (a) The scope of IPSAS 22 is very limited. It applies only when a government prepares consolidated financial statements and also discloses financial information about the GGS in its consolidated financial statements (IPSAS 22, paragraphs 1 and 2). Most governments do not include this information in their consolidated financial statements and hence do not fall within the scope of IPSAS 22. Instead information about the GGS is usually published in statistical reports.
- (b) IPSAS 22 does not permit the presentation of sector information as an alternative to full line-by-line consolidation. It requires the presentation of sector information in addition to consolidated financial statements.
- (c) When a government is within the scope of IPSAS 22 (either by voluntarily presenting information about the GGS in its consolidated financial statements or because another government has required that it present such information), IPSAS 22 specifies requirements for the disclosure of information about the GGS. The required information includes totals for assets, liabilities, revenues, expenses and categories of cash flows (paragraph 35).
- (d) The accounting policies applied in preparing the information about the GGS must be the same as for the consolidated financial statements, apart from the fact that the entity is not required to consolidate entities in the PFC and PNFC sectors (paragraphs 23 and 24). Therefore there could still be differences between the GGS information reported in accordance with IPSAS 22 and the GGS information in statistical reports.
- (e) IPSAS 22 requires that the GGS show the investment in entities in the PFC and PNFC sectors as an asset, measured at the carrying amount of the net assets of the investees (paragraph 25).
- (f) IPSAS 22 requires a reconciliation between the GGS information presented in the consolidated financial statements with the equivalent items in the consolidated financial statements. Because IPSAS 22 requires that the same accounting policies be used in both sets of information the reconciliation is not about explaining accounting policy differences. Instead the reconciliation shows the GGS versus the combined PFC and PNFC sectors (paragraph 43). The reconciliation effectively requires three columns:
 - (i) GGS;
 - (ii) PFC and PNFC sectors; and
 - (iii) Total amount shown in financial statements.

- (g) IPSAS 22 does not require a reconciliation between the GGS information presented in the consolidated financial statements with the GGS information presented in statistical reports (paragraph 46).
 - (h) IPSAS 22 does not require the disclosure of information on the PFC sector or the PNFC sector as separate sectors.
12. Although most governments prepare macroeconomic data in accordance with statistical reporting frameworks, application of IPSAS 22 appears to have been very limited. Reasons for the limited uptake of IPSAS 22 include:
- (a) At present relatively few governments prepare consolidated financial statements.
 - (b) Of those governments that prepare consolidated financial statements, many do not present financial information about the general government sector in those statements.
 - (c) Of those governments that both prepare consolidated financial statements and present financial information about the general government sector in those statements, few report in accordance with IPSASs. For example, Australian governments are required to present information about statistical sectors in their consolidated financial statements, but they report in accordance with Australian Accounting Standards rather than IPSASs. There is a separate standard which specifies the presentation of Australian Accounting Standard AASB 1049, *Whole of Government and General Government Sector Financial Reporting*.
13. The IPSASB is aware of the limited uptake of IPSAS 22 and, as part of its ongoing review of opportunities to harmonize with statistical reporting, sought constituents' views on some options in relation to IPSAS 22. The next section summarises constituents' views.

Constituents' Views on IPSAS 22 and Alignment with GFS

14. In October 2012 the IPSASB issued the Consultation Paper *IPSASs and Government Finance Statistics Reporting Guidelines* (the CP). Comments were due by 31 March 2013. Specific Matter for Comment 5 in the CP (see below) sought feedback on options concerning IPSAS 22. A comprehensive analysis of the responses to that CP is included in the agenda papers at agenda item 10. This agenda paper focuses on constituents' comments about IPSAS 22 and the role of information of statistical sectors compared to the role of consolidated financial statements.

Extract from Consultation Paper: *IPSASs and Government Finance Statistics Reporting Guidelines*

Specific Matter for Comment 5:

This CP describes three options concerning IPSAS 22: Option A, revisions to improve IPSAS 22; Option B, withdrawal of IPSAS 22 without replacement; and, Option C, replacement of IPSAS 22 with a new IPSAS.

- (a) Are there any further IPSAS 22 options that should be considered? If so, what are these?
- (b) Which one of the options do you consider that the IPSASB should consider adopting?

15. The CP noted that Option C (being replacement of IPSAS 22 with a new IPSAS), could possibly follow an approach similar to that in the Australian standard, AASB 1049. An overview of AASB 1049's approach was included in the CP and is reproduced in Appendix 1 of this memo. Respondents' comments on Specific Matter for Comment 5 are set out in Appendix 2 of this memo.

16. In the context of considering whether the approach in AASB 1049 might be suitable for adoption in the project to update IPSASs 6 to 8, some differences between IPSAS 22 and AASB 1049 are noteworthy:
- (a) AASB 1049 establishes mandatory requirements for a number of governments in Australia. IPSAS 22 could be mandatory if a higher-level government specifies GFS reporting requirements for another government, or if GFS reporting requirements are specified in legislation, but in most cases governments can choose whether or not to present GGS information in their consolidated financial statements.
 - (b) AASB 1049 requires information on the GGS in addition to the consolidated financial statements of a government. It does not permit the presentation of information on the GGS as an alternative to consolidation.
 - (c) AASB 1049 accommodates GFS principles to a greater extent than IPSAS 22. For example, IPSAS 22 does not require a comprehensive operating statement classifying items as transactions or other economic flows and presenting GFS key fiscal aggregates on the face of the financial statements.
 - (d) IPSAS 22 does not require the separate presentation of information on the public financial corporations sector and public non-financial corporations sector. AASB 1049 (paragraph 52) requires that the whole of government shall disclose by way of note, financial statements for the GGS, PNFC sector and PFC sector.
 - (e) AASB 1049 requires reconciliations between GAAP and GFS measures of key fiscal aggregates.
17. Appendix 3 to this memo provides an overview of the approach to disclosure of sectors taken by the Commonwealth Government of Australia.

Further IPSAS 22 Options to Consider

18. Respondents generally did not have further IPSAS 22 options that they wanted the IPSASB to consider. 12 respondents indicated that there were no further options. Seven respondents did not comment. Only four respondents suggested further options (R2, R11, R19 and R22).
19. The further IPSAS 22 options proposed were to:
- (a) Support IPSAS 22 by providing a separate document with guidance, such as that discussed under SMC 2 (R2);
 - (b) Include a reconciliations and/or narrative explaining the differences between the financial statement amounts and those in the GFS reports (R11 and R22); or
 - (c) Make IPSAS 22 mandatory, before deciding its future (R19).
20. Three respondents also commented that the IPSASB's decision on IPSAS 22's future should be conditional on first gathering information about the extent to which it is being applied (R3, R14 and R23).

Support for Each IPSAS 22 Option

21. Respondents' preferences regarding the three options set out in the CP were as follows:
- | | | |
|-------------|--|------------------|
| Option A | Revisions to improve IPSAS 22 | 3 |
| Option B | Withdrawal of IPSAS 22 without replacement | 8 |
| Option C | Replacement of IPSAS 22 with a new IPSAS | 6 (5 Australian) |
| Mixed views | | 4 |
| No comment | | 4 |
| Total | | 25 |
22. The majority expressing a clear opinion supported Option B (removal of IPSAS 22) but views were widespread. In addition to the 6 respondents that supported Option C as their first choice, the four respondents classified as having mixed views indicated some support for Option C (either in the future or as a second choice). Of the four mixed views, two respondents supported A now, and C later, one did not indicate a clear preference between A or C and one gave two views (B and C) depending upon the perspective taken. Of those indicating support for option C, some indicated that this project should not be regarded as a priority.

Optional WOG Consolidation, Mandatory Statistical Sector Consolidation

23. At the IPSASB's March 2013 meeting, it was proposed that the IPSASB explore the option of requiring mandatory line-by-line consolidation within a statistical sector, and optional whole of government consolidation. The arguments for and against this option are considered in this section. The differences between this proposal and the options A to C outlined in the CP are also explained. A summary of this new proposal (referred to as Option D) is set out in Table 1.

Table 1 New Proposal – Option D

Optional	Whole of Government Line-by-line consolidation of all controlled entities		
Mandatory for all sectors	General Government Sector GG Line-by-line consolidation of all controlled entities except for Investments in PNFC and PFC entities could be measured at fair value or carrying amount of net assets.	Public Non-Financial Corporations PNFC Line-by-line consolidation of all controlled entities in this sector.	Public Financial Corporations PFC Line-by-line consolidation of all controlled entities in this sector.

Scope

24. Option D would apply at the whole of government level. It would not apply to individual public sector reporting entities other than governments. Individual public sector reporting entities other than governments would continue to present consolidated financial statements in accordance with the IPSAS dealing with consolidated financial statements. The IPSASB would need to decide whether this option should be available to central governments only or to any government including state, provincial and local governments.
25. The proposal could be given effect by limiting the scope of the IPSAS dealing with consolidated financial statements (currently IPSAS 6) and changing the scope of IPSAS 22 to make it mandatory for all governments.

Location of Sector Information

26. If consolidation of all controlled entities were to be optional, the sector information would need to be presented as part of the government's financial statements. This would be consistent with IPSAS 22 but differs from the requirements of AASB 1049 in that AASB 1049 permits sector information to be presented in another document.
27. Option D would be closest to Option C in the CP. It would require substantial changes to IPSAS 22 and would probably lead to reconsideration of a number of requirements in IPSAS 22.

Accounting Policy Requirements

28. IPSAS 22 requires that the GGS shall be prepared in accordance with the same accounting policies as used in the consolidated financial statements, apart from the non-consolidation of entities belonging to other sectors (paragraphs 23 and 24). This requirement would need to be reviewed. If an entity made use of the option not to present consolidated financial statements there would not be any consolidated financial statements. In addition, there could be significant differences between GFS information and financial statements due to different accounting policy choices. AASB 1049 minimises this issue by specifying the accounting policy options to be used.
29. In the context of international statistical reporting frameworks it would be more difficult to follow the approach taken by Australia. Although there are international statistical reporting frameworks, individual countries have national requirements which may mandate different treatments. If the IPSASB were to take this approach it would need to reference international requirements and then consider how to address differences due to differing national requirements.
30. Currently IPSAS 22 requires that the GGS shall recognize its investment in the other sectors as an asset and shall account for that asset at the carrying amount of the net assets of its investees (paragraph 25). By contrast AASB 1049 requires that the GGS shall recognize its investment in the other sectors at fair value (if reliable) or the carrying amount of net assets. If substantial changes were being made to IPSAS 22 this difference could be reconsidered.

Line Items and Disclosure

31. IPSAS 22 requires fairly detailed disclosures (paragraph 35). It is similar to the level of detail required by AASB 1049. If these disclosures were to be mandatory for all governments (and possibly the only form of information presented) it is likely that the IPSASB would take the

opportunity to review the disclosures. One issue to be considered is whether they could be better aligned with the presentation of items in statistical reports.

32. On a more general note, if this approach were to be developed further the IPSASB would need to consider whether the disclosure requirements in IPSASs needed to be amended. For example, the IPSAS 1 disclosures were developed in the context of a reporting entity's financial statements. The IPSASB would need to consider whether the disclosures should apply equally to all three statistical sectors or to the GGS only. Similar questions could be asked about many of the disclosures required by IPSASs.

Non-resident Units

33. GFS focuses on resident units. If the IPSASB were to consider permitting presentation of sector information alone, then it would need to decide how to incorporate information about non-resident units within the information presented. This issue was considered in Australia but the standard setting body decided that the issue was not significant in practice. The Basis for Conclusions on AASB 1049 explains the matters considered.

Extract from the Basis for Conclusions on AASB 1049

BC26 Generally, the controlled entities that are not consolidated within the GGS would be consolidated under both GAAP and GFS in whole of government financial reports, and therefore one of the more controversial aspects dealt with in the context of GGS financial reporting (see paragraphs BC5-BC13) does not arise in the context of whole of government. However, a different kind of non-consolidation issue conceivably arises. Under GAAP, irrespective of residency, all controlled entities are consolidated. Under GFS, controlled non-residents are not consolidated. For example, an off-shore subsidiary of a PNFC sector entity or PFC sector entity is not consolidated under GFS because it is not part of the Australian economic territory. Instead GFS records the parent PNFC sector or PFC sector entity as having an equity investment in the non-resident subsidiary and deriving dividend income from it. The non-resident subsidiary is an institutional unit in the economic territory of the other economy that would be part of that other economy's private sector.

BC27 The Board concluded that, consistent with AASB 127, all controlled entities should be consolidated on a line-by-line basis in whole of government financial reports. If material, the GFS non-consolidation of non-resident subsidiaries would be shown as a reconciling difference (see paragraphs BC40(c) and BC52). The Board noted that Australian jurisdictions either do not have non-resident subsidiaries or have immaterial non-resident subsidiaries. Given that the issue is not significant in practice, the Board concluded that it is not necessary for the Standard to explicitly refer to the issue.

34. If the IPSASB continued to require the presentation of whole of government information then non-resident subsidiaries could be shown as a reconciling difference between the whole of government information and the GFS information. However, if whole of government information was not presented the IPSASB would need to decide how to address this issue.

Arguments for and against Option D

35. There are two parts to Option D: (i) whether consolidation at a whole of government level should be optional; and (ii) whether consolidated information for each of the GGS, PNFC and PFC sectors should be mandatory. This section considers mandatory sector information first.
36. Mandatory presentation of consolidated information for the three key statistical sectors was not specifically raised as an option in the recent CP. However, some constituents considered this possibility. Key points from their comment letters are as follows:

- (a) Respondent 003 noted that at the time IPSAS 22 was issued the IPSASB itself was not convinced that the benefits of GGS disclosures would always outweigh the costs. This is why IPSAS 22 has such a narrow scope. The respondent referred to the points made in IPSAS 22 paragraph BC5.
 - (b) Most of the respondents that supported Option C were Australian respondents who are therefore familiar with the application of AASB 1049. These respondents highlighted the importance of budget information, the central role of GGS information in budgeting in Australia, and the fact that this is an integrated approach which reduces the number of differences between the two sets of information. However, most of these respondents also envisaged that consolidated whole of government reports would continue to be required.
 - (c) If the IPSASB keeps IPSAS 22, it should be optional. [Respondent 010. Respondent 024 made similar comments from a preparer perspective]
 - (d) If the IPSASB keeps IPSAS 22 (and revises it to provide a better bridge between IPSAS and GFS reporting) it should be mandatory. [Respondent 012]
 - (e) Reconciliations between consolidated financial statements and national accounting are more useful than IPSAS 22 disclosures. [Respondents 011 and 022]
 - (f) IPSAS 22 could be made mandatory as one means of obtaining better information about the effectiveness of the principles in IPSAS 22. [Respondent 019]
37. Arguments for optional consolidation at a whole of government level include:
- (a) It would directly address the concerns of some regarding the consolidation of certain controlled entities such as financial institutions and market producers. These concerns primarily relate to the fact that due to the size or nature of activities conducted by these controlled entities it can be difficult to assess the financial performance and position of the core government. For example, the financial assets and financial liabilities of financial institutions could have a significant impact on the consolidated statement of financial position.
 - (b) Making consolidation optional at a whole of government level would significantly reduce compliance costs.
 - (c) It would be consistent with the way some jurisdictions manage public finances.
38. The key argument against optional consolidation at a whole of government level is that it goes against the principle of using control to determine the reporting entity. It would represent a fundamental change in what is regarded as generally accepted accounting practice. The arguments against permitting exemptions from consolidation requirements have been addressed in agenda papers at previous IPSASB meetings and are considered in more detail in agenda paper 3.1 on investment entities.
39. A number of respondents to the CP expressed concerns about placing too much emphasis on GFS reporting in the context of IPSASs. Comments by Respondent 22 which outline these concerns are shown below.

Extract from Respondent 22 Comment Letter

[The Council] finds that several points highlight the need for vigilance on the search for alignment, especially if it is to be systematised.

- As the Consultation Paper clearly states, the two systems have very different objectives: general purpose accounting is based on general principles and standards and aims to render a true account of the financial position of a particular independently functioning entity, whilst national accounting (such as the GFS which derived from national accounting) is an accounting framework³ for presenting results of economic sectors and their interactions.
- The two systems' scope is not identical. Although both systems speak of the "public sector", the content of this public sector cannot be superimposed between the IPSASs and the GFS. Indeed, the preface to the IPSASs states that they concern "public sector entities" without defining these. It also says that they do not apply to public enterprises that carry out commercial activities⁴, whereas the GFS describe on the one hand the results of "general government" and on the other hand those of the "public sector".
- The IPSASs employ the concept of "control" to define consolidation scopes and not to identify the entities that must apply these standards. In national accounting and the GFS, the concept of control is used to include in the "general government" sector entities controlled by public authorities and their executive bodies⁵.
- The two systems are designed for different purposes: the IPSASs concern autonomous entities that issue financial statements whereas the GFS describe an institutional sector. A sector in the national accounting sense is not an entity. The institutional sector is the sum of institutional units. It does not belong to an autonomous entity with its own economic logic and strategy. The reporting entity principle does not apply to national accounting. National accounting does not issue financial statements, but chiefly provides economic data in an accounting framework that is used to describe interactions among sectors or sub-sectors.

40. Similar points about the different nature of the two reporting systems are made in the UK Whole of Government Accounts (WGA). These accounts include a narrative description of the differences between the WGA and the National Accounts. An extract from this comparison is shown below.

Extract from UK Whole of Government Accounts: year ended 31 March 2011

3.90 WGA is a complement to, rather than a substitute for, the financial information the Government and other independent bodies already publish. WGA does not replace the statistics published by the independent Office for National Statistics (ONS), which follow the internationally agreed National Accounts system. The two systems of accounting have evolved independently of each other, use different international standards, and have been designed for different purposes. The National Accounts are used to assess the economic and fiscal position of the UK for policy purposes and are prepared under an internationally-agreed framework which facilitates monthly and quarterly fiscal statistics. They follow Europe-wide guidelines on the measurement of the UK economy which enables comparison to other European governments' fiscal aggregates. WGA shows audited accounting standards-based numbers which provide insights into long-term sustainability, as well as presenting the figures in a format familiar to the commercial sector and the wider accountancy profession.

3.91 The key differences between what National Accounts and WGA cover are that WGA measures of net assets and liabilities using IFRS based standards include a full assessment of the Government's assets, including physical and illiquid financial assets, and include liabilities on future payments, such as public service pensions. WGA also discloses contingent liabilities.

Segment Reporting and GFS

41. Some might suggest that information on statistical sectors could be regarded as segment information. Although the provision of information on the GFS in accordance with IPSAS 22 is a disaggregation of information the financial statements, current IPSASs explicitly state that reporting information on the basis of statistical sectors alone would be unlikely to meet the requirements of

IPSAS 18. Relevant extracts from IPSAS 18 and IPSAS 22 are shown below. If the IPSASB wished to pursue this idea it would require changes to both of these IPSASs and would be more appropriately considered within the context of the project on *Alignment of IPSASs with Public Sector Statistical Reporting Guidance*.

Extract from IPSAS 18, *Segment Reporting*

Reporting Structures not Appropriate

24. As noted above, in most cases the segments for which information is reported internally to the governing body and the most senior manager of the entity, for the purpose of evaluating the entity's past performance and for making decisions about the future allocation of resources, will reflect those identified in budget documentation and will also be adopted for external reporting purposes in accordance with the requirements of this Standard. However, in some cases an entity's internal reporting to the governing body and the senior manager may be structured to aggregate and report on a basis that distinguishes revenues, expenses, assets, and liabilities related to budget-dependent activities from those of trading activities, or which distinguishes budget-dependent entities from GBEs. Reporting segment information in the financial statements on the basis of only these segments is unlikely to meet the objectives specified for this Standard. This is because these segments are unlikely to provide information that is relevant to users about, for example, the performance of the entity in achieving its major operating objectives. IPSAS 22, *Disclosure of Financial Information about the General Government Sector*, includes requirements for governments that elect to disclose financial information about the general government sector (GGS) as defined in statistical bases of reporting.
25. In some cases, the disaggregated financial information reported to the governing body and the senior manager may not report expenses, revenues, assets, and liabilities by service segment, geographical segment, or by reference to other activities. Such reports may be constructed to reflect only expenditures by nature (for example, wages, rent, supplies, and capital acquisitions) on a line item basis that is consistent with the budget appropriation or other funding or expenditure authorization model applicable to the entity. This may occur where the purpose of financial reporting to the governing body and senior management is to evidence compliance with spending mandates rather than for purposes of (a) evaluating the past performance of the entity's major activities in achieving their objectives, and (b) making decisions about the future allocation of resources. When internal reporting to the governing body and senior manager is structured to report only compliance information, reporting externally on the same basis as the internal reporting to the governing body and senior manager will not meet the requirement of this Standard.

Extracts from IPSAS 22, *Disclosure of Financial Information about the General Government Sector*
Segment Reporting

7. IPSAS 18, *Segment Reporting*, requires the disclosure of certain information about the service delivery activities of the entity and the resources allocated to support those activities for accountability and decision-making purposes. Unlike the sectors reported under statistical bases of financial reporting, segments reported in accordance with IPSAS 18 are not based on a distinction between market and nonmarket activities.
8. The disclosure of information about the GGS does not replace the need to make disclosures about segments in accordance with IPSAS 18. This is because information about the GGS alone will not provide sufficient detail to enable users to evaluate the entity's past performance in achieving major service delivery objectives, when those objectives are achieved through non-GGS entities. For example, identifying the GGS as a segment will not provide information about a government's performance in achieving its telecommunication, healthcare or educational objectives, where government corporations or quasi-corporations deliver services related to those objectives. Because the GGS is only a subset of the government as a whole, important information would be omitted if a government did not present segment information in respect of its consolidated financial statements.

Segment Reporting

BC10. IPSAS 18 requires the separate disclosure of certain information about significant activities or groups of activities for the evaluation of the performance of the entity in achieving its objectives, and for decision-making purposes. IPSAS 18 does not distinguish between exchange and non-exchange transactions and events, or market and nonmarket activity of government. Rather, its focus is on the disclosure of the revenues, expenses, assets, and liabilities associated with the delivery of major services or groups of services – whether these services are delivered by the GGS of the government or by PFCs and PNFCs. The objective of segment reporting is not achieved by the disclosure of information about the GGS. Accordingly, a government electing to disclose information about the GGS needs also to disclose information about segments.

BC11. Statistical bases of financial reporting present information about expenses or expenditure of the government, classified either by economic nature or the COFOG. Either of these classification bases may be applied to disclose additional information about the GGS. In some cases a COFOG classification may be adopted to disclose segment information in a government's consolidated financial statements.

Basis for Recommendations

42. In considering the factors that would help the IPSASB come to a conclusion on this proposal, staff took the view that a move away from the established principle of consolidation of all controlled entities would need to be strongly justified. In the case of investment entities the IASB has accepted that there is evidence that there is a group of users for whom other information is more relevant. There was fairly strong consensus from the users of investment entities that they had a higher need for fair value information than consolidated financial statements.
43. In the context of public sector entities and statistical reporting, the question is whether there is sufficiently strong evidence that (i) there is a group of users for whom statistical sector information is more relevant than consolidated financial statements and (ii) those users have consistent views. Although the responses to the recent CP are limited in number, they indicate that there is no clear consensus about the usefulness of statistical sector information in financial statements or on the priority of this form of reporting for the IPSASB.
44. Different jurisdictions have different approaches to the inclusion of statistical information in financial statements and some respondents expressed a preference for reconciliations rather than disaggregated reporting.
45. It is for these reasons that staff recommend that the IPSASB does not proceed with the proposal to require the presentation of consolidated information for the GGS, PNC and PNFC sectors and optional consolidation across those sectors. Staff also recommends that the issue of whether IPSAS 22 should be mandatory should be considered in the project on *Alignment of IPSASs with Public Sector Statistical Reporting Guidance*.

Recommendations

46. It is recommended that the IPSASB:
 - (a) NOTE that in March 2013 it was suggested that the IPSASB consider a proposal to have optional whole of government reporting and mandatory GFS sector reporting at a whole of government level;

- (b) NOTE that some of the comments made by respondents to the Consultation Paper *IPSASs and Government Finance Statistics Reporting Guidelines* (CP) were relevant to consideration of this proposal;
- (c) NOTE that although this proposal was not specifically raised in the CP, respondents were not generally supportive of the IPSASB devoting more resources to presentation of GFS information in financial statements. By contrast, most Australian respondents supported an integrated approach to GFS reporting similar to AASB 1049;
- (d) NOTE that one CP respondent supported IPSAS 22 being mandatory [Respondent 012];
- (e) NOTE that one CP respondent proposed optional whole of government reporting [Respondent 002];
- (f) NOTE that staff consider this proposal would require a detailed review of not only IPSAS 22 but also the interaction between IPSAS 22 and other IPSASs;
- (g) NOTE that current IPSASs explicitly state that reporting information on the basis of statistical sectors alone would be unlikely to meet the requirements of IPSAS 18;
- (h) AGREE not to permit optional presentation of consolidated financial statements (in conjunction with mandatory sector reporting) at a whole of government level in the context of the project to update IPSASs 6 to 8; and
- (i) AGREE to consider the issue of whether IPSAS 22 should be mandatory should be considered in the project on *Alignment of IPSASs with Public Sector Statistical Reporting Guidance* (addressed in agenda item 10) and the full analysis of submissions on the CP.

Matter(s) for Consideration

1. Does the IPSASB agree with the above recommendations?

Appendix 1 AASB 1049 Approach

The following overview of Australian Accounting Standard AASB 1049 *Whole of Government and General Government Sector Financial Reporting* was included in the Consultation Paper *IPSASs and Government Finance Statistics Reporting Guidelines*.

AASB 1049, *Whole of Government and General Government Sector Financial Reporting*

In Australia, separate application of generally accepted accounting practice (GAAP) requirements and GFS guidelines was viewed by some significant users as causing confusion, because two sets of accrual-based financial statements appeared in governments' reports, reporting different results for the same public sector entity. Australia's Financial Reporting Council asked the Australian Accounting Standards Board (AASB) to develop a framework that harmonized the two financial reporting structures—GAAP and the GFS—to achieve an Australian accounting standard for a single set of government reports. AASB 1049, *Whole of Government and General Government Sector Financial Reporting* (AASB 1049), was initially issued in 2006 to address GGS financial reports, and was reissued in 2007 to also cover whole of government financial reports. A post-implementation review of AASB 1049 took place in 2010–2011. The review identified some areas of improvements, resulting in recent amendments to the Standard, but did not identify any major problems with the Standard's approach.

AASB 1049 takes an integrated approach to GGS and consolidated government financial statements. It specifies requirements that apply to both types of financial reports. The integrated approach reflects (a) the strong relationship between consolidated government financial statements and GGS financial reports, and (b) the importance placed on ensuring that reporting requirements are expressed in the same way for GGS and a government's consolidated financial statements. Requirements differ only where a difference is necessary.

AASB 1049 treats GAAP/GFS harmonized reports relating to the consolidated government (which includes the sectors therein, including the GGS) as falling within general purpose financial reporting, with all requirements that apply to GPFs also applying to GAAP/GFS harmonized reports. At the same time, AASB 1049 establishes the GAAP authority for GAAP/GFS harmonized reports to present the (partially consolidated) GGS, in addition to the (fully consolidated) government financial statements.

AASB 1049 applies GAAP definition, recognition, and measurement principles in almost all cases. This is possible because of the substantial alignment between full accrual reporting and GFS reporting, discussed earlier.²⁵

The main changes that AASB 1049 introduced to Australia's public sector GAAP to facilitate GAAP/GFS harmonization were:

1. **Presentation:** Modification of GAAP presentation principles to accommodate GFS principles to encompass a comprehensive operating statement that retains the GAAP classifications but overlays them with a transactions/other economic flows classification approach based on GFS reporting guidelines.
2. **Disclosures:**
 - (a) Expanding disclosure requirements to accommodate, on the face of the statements, key GFS fiscal aggregates and the distinction between cash flows relating to investing in financial assets for policy purposes and for liquidity management purposes adopted by the GFS; and
 - (b) Specifying supplementary disclosure requirements, including GFS measures of key fiscal aggregates, reconciliations between GAAP and GFS measures of key fiscal aggregates and explanations of differences between GAAP and GFS.
3. **Option:** Where an accounting standard allows optional treatments, AASB 1049 mandates that governments shall apply only those treatments that align with GFS guidelines.

²⁵ The accounting standards applicable to Australian public sector entities are full accrual standards, which are, in substance, the same as IPSASs. Their similarity to IPSASs arises from the Australian convergence with IFRSs, with public sector-specific differences that generally align with IPSAS differences.

Appendix 2 Consultation Paper – Responses to Specific Matter for Comment 5

This Appendix contains respondents' comments on Specific Matter for Comment 5 in the recent Consultation Paper *IPSASs and Government Finance Statistics Reporting Guidelines*. A comprehensive list of respondents and an analysis of the responses to the Consultation Paper is set out in agenda item 10. The classification of responses are staff views and do not necessarily reflect the views of IPSASB Members.

Option A	Revisions to improve IPSAS 22	3
Option B	Withdrawal of IPSAS 22 without replacement	8
Option C	Replacement of IPSAS 22 with a new IPSAS	6 (5 Australian)
Mixed views		4
No comment		4
Total		25

	Option	Selected Comments
001	B	IPSASB should consider adopting Option B, the withdrawal of IPSAS 22. IPSAS 22 was created to encourage the disclosure of the GGS information, particularly in those jurisdictions in which national or other governments, publish both financial statements in accordance with IPSASs and financial information in accordance with statistical bases of financial reporting. Unfortunately, based on the analysis conducted by IPSASB it appears that the IPSAS is not producing its intended result. Consequently, the IPSAS should be withdrawn. Some of the revisions listed in Option A require further work on the part of the preparer and as a result, may not encourage the voluntary compliance with IPSAS 22. The integrated approach offered in option C appears to be very similar to IPSAS 22. Replacing IPSAS 22 with a new IPSAS similar to AASB 1049 which is comparable to IPSAS 22 may end up with the same result as the current IPSAS. It is for these reasons, that the withdrawal of IPSAS 22 is preferred.
002	A	We believe that the Whole-of-Government column in the illustrations should be optional. Our preferences (in order) are as follows: 1. Option A, 2. Option C, and 3. Option B.
003	B	Before reaching a final decision on its actions in relation to IPSAS 22 we would encourage the IPSASB to assess international demand by evaluating whether this standard has been applied widely in practice. Also, as BC 4 of IPSAS 22 points out, this standard was originally viewed as a means of facilitating convergence. The IPSASB itself was not convinced (BC 5) and thus IPSAS 22 disclosures are not mandatory. Unless there is a compelling case, we doubt there is a strong argument to support the allocation of IPSASB's resources to the revision or replacement of this standard. In addition to our comments in the preceding paragraphs, given this current initiative as well as the recent on-going developments in GFS we tend to support option B.
004	B	The committee recommends that Option B be selected since if the other standards will be amended to reflect the necessary changes, there does not need to be a separate standard addressing the differences between IPSAS and GFS.
005	C	[The respondent] supports Option C, replacing IPSAS 22 with a new IPSAS. That new IPSAS should set out an "integrated approach" for application when a government prepares financial reports for the General Government Sector and the whole of government under IPSAS/GFS harmonised requirements. It should require compliance with all other IPSASs, except for departures specifically stated in the new IPSAS. It should include guidance on how to prepare such statements including: (i) a list of accounting policy choices under IPSASs for which there is a GFS-preferred option;

	Option	Selected Comments
		<p>(ii) a list of key differences between IPSASs and GFS; and</p> <p>(iii) illustrative financial statements under IPSAS/GFS harmonised requirements. ACAG supports a choice between quantitative or narrative reconciliations. ACAG believes that solely quantitative reconciliations can be difficult for users to understand.</p>
006	C	<p>Australia has adopted an integrated approach with a single standard for both the GAAP and the GFS, called AASB 1049 <i>Whole of Government and General Government Sector Financial Reporting</i> ... ABS consider that it would be a backward step to withdraw IPSAS 22 without replacement....</p>
007	A	<p>We very much like the approach the UK government has taken in respect of its whole of government accounts (2009-10 and 2010 -11) where it has set out in plain English the differences between the financial statements and government finance statistics reports. Countries which publish consolidated accounts should be encouraged to include similar explanations which will help to ensure that the users of accounts better understand the differences and similarities between the two sets of financial statements and have a complete picture of a government's finances. Also, we believe that there are lessons to be learnt from countries such as Australia where the standard setter has attempted to reduce the differences between government's consolidated accounts and GFS.</p> <p>We consider option one (<i>assumed to be option A by the IPSASB staff</i>) to be the most practicable approach.</p>
008	C	<p>We are advocates for a single integrated accounting standard that specifies requirements for both whole of government financial reports and general government sector (GGS) financial reports as we believe it is this approach that best reflects the relationship between the various organisations. Australia's state, territory and national governments are managed using GGS information prepared on a partial consolidation basis (i.e., budget information). We believe it appropriate that AASB 1049 require each of those governments to prepare a whole of government financial report in accordance with consolidation requirements, and thereby separately recognise assets, liabilities, income, expenses and cash flows of all entities under their control on a line-by-line basis. Further, given the importance of the budget information and the fact that AASB 1049 itself prescribes the particular requirements for the scope of the GGS and form and content of the GGS financial report, we are comfortable with the approach taken in Australia whereby:</p> <ul style="list-style-type: none"> • only government controlled entities that fall within the boundary of a GGS are consolidated in a GGS financial report; and • the accounting standard does not specify whether: <ul style="list-style-type: none"> ○ the GGS is a reporting entity; ○ a financial report of the GGS that is prepared in accordance with the accounting standard is a general purpose financial report. <p>We support Option C, replacement of IPSAS 22 with a new IPSAS. As advocates for a single integrated accounting standard, we encourage the IPSASB to develop a new IPSAS that specifies requirements for both whole of government financial reports and general government sector (GGS) financial reports as we believe it is this approach that best reflects the relationship between the macro-economic focused GGS of a government, the other sectors of the government and the whole of government. It is our experience that governments are managed using GGS information prepared on a partial consolidation basis (i.e., budget information).</p> <p>We envisage a new IPSAS that would prescribe the particular requirements for the scope of the GGS and form and content of the GGS financial report (i.e., a partial consolidation basis whereby only government controlled entities that fall within the boundary of a GGS are consolidated). The whole of government financial report would be prepared in accordance with the IPSAS 6</p>

	Option	Selected Comments
		<i>Consolidated and Separate Financial Statements</i> , and thereby separately recognise assets, liabilities, income, expenses and cash flows of all entities under the control of the government on a line-by-line basis.
009	B	The SRS-CSPCP is of the opinion that IPSAS 22 can be withdrawn without replacement. However, in the individual standards the differences to GFS should be mentioned and discussed, as is already the case in the IFRS (see Paragraph 5.4.). In the 4th part of the General Framework (Presentation of financial information and non-financial information in GPFRs) the framework for a narrowing of the practices in financial statements and GFS can be laid, to the extent that from the aspect of IPSAS this is possible without impairing their own objectives.
010	B	<p>Amongst governments that issue accrual-based consolidated financial statements, none of them have chosen to provide disclosures required by IPSAS 22, as part of their general purpose financial reports (GPFRs) (paragraph 5.25 of CP). Therefore, we suggest that IPSASB should withdraw IPSAS 22, in order to save its resources for other standard setting activities.</p> <p>When we compare financial information and statistical information, we note that their objectives, concepts and preparation methods are very different. Therefore, we believe that it is sufficient to describe the relations between the two standards in the relevant IPSAS Appendices, for example, of IPSAS 1, 2, 6 to 8, or 18, rather than requiring to be consistent with GFS applicable to general government sector (GGS) financial reporting and the consolidated government financial statements, as proposed in Option C, of paragraph 5.26 (a) of the CP.</p> <p>If the IPSASB chooses to include it in the body of IPSASs, we suggest that this disclosure requirement be voluntary.</p>
011	B	<p>a) As mentioned above, as the scopes of the IPSAS and the GFS differ (one is based on control whereas the other leans on the institutional units), we wonder about the usefulness of IPSAS 22. Furthermore, the scope discrepancy related to the exclusion of non-resident institutional units is not addressed by IPSAS 22. So, information provided by IPSAS 22 is not useful for the users of financial statements, as they require restatement for their disclosure to match with national accounts' information. That is why the cost-effectiveness of this disclosure appears unfavourable. By contrast we do not neglect the interest, for the financial statement users, to disclose the information which allows bridging the key aggregates of national accounting with financial statements under IPSAS. So, in France, the general purpose financial report, which is not an accounting document, provides comments to the accounts. It includes a reconciliation table for the debt to bridge amount disclosed in the central government financial statements and the amount disclosed in national accounting.</p> <p>We consider that this selected information is more reliable than the one required by IPSAS 22.</p> <p>b) For us, IPSAS 22 must be removed.</p>
012	A or C	<p>Having two different sources of financial reporting requirements for the government may be confusing to both users and stakeholders and reduces international comparability. Therefore more clarity should be given to the users of financial statements. We believe that either option A (revision of IPSAS 22 to provide a better bridge between IPSAS and GFS reporting) or option C (integrated approach to financial statements and GFS) could help achieve this objective, and comment below on the circumstances that the IPSASB should in our view consider in selecting one or other option.</p> <p>If option A is chosen, IPSAS 22 'Disclosure of financial information about the general government sector' should become a mandatory standard for those governments that make GFS reporting publicly available, rather than an optional one. In doing so, the IPSASB could consider minimum disclosure requirements to address in a clear and understandable way the most important reconciliation areas, and additional optional disclosures whose relevance would need to be</p>

	Option	Selected Comments
		<p>assessed by the government.</p> <p>If option C is chosen, we would not force mandatory alignment with GFS measurement guidelines at all cost. As mentioned under questions 1 and 3, the development of new standards and the selection of accounting policies should be guided by the principles included in the IPSAS conceptual framework (under development) and the principles included in IPSAS 3. Furthermore, convergence with IFRS should also be considered to the greatest possible extent.</p>
013	C	<p>On balance we support Option C, although we would not attach any additional priority to this work, which we would expect to be progressed after other more urgent items.</p> <p>IPSAS 22 may provide useful information, but it is written with a focus on Government Financial Statistics rather than as an enhancement to financial statements prepared under IPSAS. It does not read-across or cross-reference to other IPSAS standards on related topics. Rather than piecemeal revision we suggest that it would be better to develop a replacement standard, even though this might include some similar content.</p>
014	-	<p>IPSAS 22... applies only to those governments that elect to present information about the general government sector. BC 4 of IPSAS 22, "The IPSASB supports the convergence of IPSASs with statistical bases of reporting where appropriate. The statistical community encouraged the IPSASB to develop an IPSAS addressing the presentation of GGS information as part of a government's consolidated financial statements as a means of facilitating convergence." This implies that it is not mandatory unlike other IPSASs. We would urge IPSASB to assess global uptake of this standard before making a decision on the next course of action.</p> <p><i>No specific response to SMC 5 options noted.</i></p>
015	C	<p>As mentioned above, the majority of HoTARAC supports Option C: adopting an integrated approach along the lines of the Australian accounting standard AASB 1049.</p>
016	C	<p>We are of the view that option C should be pursued given that IPSAS 22 has had limited uptake around the world. Instead of attempting to "fix" IPSAS 22, it may be more appropriate to start with the development of a new IPSAS, which is based on the identification of users' information needs. While we have not fully investigated the Australian model outlined in the paper, we support the idea of following an integrated approach to reporting GGS and consolidated information.</p> <p>Based on our discussions with the National Treasury, it was indicated that preparing GGS information could be seen as a relevant intermediate step to the preparation of a complete consolidation based on control (as required by IPSAS 6). We do however acknowledge that this might be more relevant for some jurisdictions than others, depending on the structure of government and what is seen to be "whole-of-government".</p>
017	A	<p>I suggest more important Option A, revisions to improve IPSAS 22.</p>
018	A now C later	<p>We note that IPSAS 22 is not a mandatory standard at the moment and we question whether there has been adequate time allowed for IPSAS 22 to be used in practice, and to collect feedback on the usefulness and other implementation issues (similar to a post-implementation review) of IPSAS 22 in practice. Following the post-implementation review, then the IPSASB could make an informed decision on IPSAS 22. We think that as a medium term solution, option A would seem to be the suitable next step.</p> <p>However, as noted previously in our cover letter, we think that ultimately IPSAS 22 should be replaced with a new IPSAS (ie option C be adopted).</p>
019	A now C later	<p><i>Extract from response to SMC1(b)</i></p> <p>The CP does not refer to a range of other differences between IPSASs and GFS requirements, in particular those that do not affect the measurement of key fiscal aggregates such as net operating balance, net lending/(borrowing) and net worth. For example, there are differences in</p>

	Option	Selected Comments
		<p>consolidation eliminations for the whole of government financial statements. In particular, under GFS, certain transactions between the GGS and entities within the Public Non-Financial Corporations (PNFC) sector and Public Financial Corporations (PFC) sector are not eliminated on whole of government consolidation, whereas under IPSAS 6 <i>Consolidated and Separate Financial Statements</i> intragroup transactions that are not transactions with external parties are eliminated in full. The GFS treatment has the effect of ‘grossing up’ both GFS revenue and GFS expenses by equal amounts. For example, a GGS may compensate a PNFC sector entity for a community service obligation, imposed by the GGS, that requires the PNFC sector entity to provide free services to a cohort of private individuals. The compensation provided by the GGS to the PNFC sector entity is not eliminated for whole of government reporting under the GFS Manual (instead it is ‘rerouted’ through the household sector of the economy and therefore treated as an expense of the GGS to the household sector, and an expense of the household sector to the PNFC sector entity, and therefore revenue of the PNFC sector entity).</p> <p><i>Repsonse to SMC5</i></p> <p><i>(a) Further IPSAS 22 Options</i></p> <p>Before contemplating making improvements to IPSAS 22... the AASB suggests the IPSASB should first obtain evidence of the effectiveness of the principles in IPSAS 22. Given the low uptake of IPSAS 22, this evidence could be collected only after making IPSAS 22 mandatory. Accordingly, the AASB suggests the IPSASB considers making IPSAS 22 a mandatory Standard, rather than an effectively optional one. The IPSASB could establish a project to consider amendments to IPSAS 22 that could be made in due course, such as requiring governments to adopt accounting policy options in IPSASs that are more closely aligned with GFS requirements.</p> <p><i>(b) Which Option Should the IPSASB Consider Adopting?</i></p> <p>As noted in response to (a), the AASB suggests the IPSASB considers making IPSAS 22 a mandatory Standard and in due course amending it based on evidence derived from its adoption. Depending on the evidence, this could lead to Option C – replacing IPSAS 22 with a new IPSAS that adopts an integrated approach. This would allow the GFS-related requirements to be collected in one IPSAS rather than scattered through the many IPSASs.</p> <p>Other IPSASs, such as IPSAS 1 <i>Presentation of Financial Statements</i>, would not be complicated by the need to specify GFS-related reporting requirements. Under this approach, just one IPSAS would need to be updated for GFS developments, instead of potentially having to update a number of IPSASs. That would be required even if other IPSASs merely included GFS comparisons as a matter of note.</p> <p>Whereas paragraph 5.26 of the CP refers to the identification of IPSAS options that are aligned with GFS, greater benefits would ensue from the replacement IPSAS if it were to require governments to adopt GFS-aligned options that are consistent with IPSASs. This could significantly reduce differences between IPSASs and GFS requirements.</p>
020	-	<p>In response to SMC 4</p> <p>...The operational validity of IPSAS 22 is not settled, because that standard does not provide a path, precise enough to reach the projected goal. Whatever were the issues decided by the IPSAS Board on IPSAS 22, the priority should be to explain the bridges between one system (IPSAS) and the other (GPS), through an adequate analysis of gaps between the perimeters of both of them (especially on entities under review in the financial statements and their inclusion into the public sector statistical categories as defined by GPS).</p> <p><i>No specific response to SMC 5 options noted.</i></p>
021	-	<p>..Therefore some differences should not be cancelled concerning, among others: a) definitions of reporting entity; b) measurement criteria.</p> <p>Statistical guidelines provide authoritative and unambiguous definitions of public sector, while in a</p>

	Option	Selected Comments
		<p>domestic jurisdiction an entity may be expected to prepare financial reporting according to public sector accounting standards depending on the provisions of national laws, regulations and other statutes. Because of this reason, public sector as defined according to statistical guidelines may differ from public sector as resulting from national rules and harmonization could be a difficult objective to pursue under this perspective.</p> <p><i>No specific response to SMC 5 options noted.</i></p>
022	B	<p><i>General comments</i></p> <p>[The Council] finds that several points highlight the need for vigilance on the search for alignment, especially if it is to be systematised.</p> <ul style="list-style-type: none"> As the Consultation Paper clearly states, the two systems have very different objectives: general purpose accounting is based on general principles and standards and aims to render a true account of the financial position of a particular independently functioning entity, whilst national accounting (such as the GFS which derived from national accounting) is an accounting framework³ for presenting results of economic sectors and their interactions. The two systems' scope is not identical. Although both systems speak of the "public sector", the content of this public sector cannot be superimposed between the IPSASs and the GFS. Indeed, the preface to the IPSASs states that they concern "public sector entities" without defining these. It also says that they do not apply to public enterprises that carry out commercial activities⁴, whereas the GFS describe on the one hand the results of "general government" and on the other hand those of the "public sector". The IPSASs employ the concept of "control" to define consolidation scopes and not to identify the entities that must apply these standards. In national accounting and the GFS, the concept of control is used to include in the "general government" sector entities controlled by public authorities and their executive bodies⁵. The two systems are designed for different purposes: the IPSASs concern autonomous entities that issue financial statements whereas the GFS describe an institutional sector. A sector in the national accounting sense is not an entity. The institutional sector is the sum of institutional units. It does not belong to an autonomous entity with its own economic logic and strategy. The reporting entity principle does not apply to national accounting. National accounting does not issue financial statements, but chiefly provides economic data in an accounting framework that is used to describe interactions among sectors or sub-sectors. <p><i>Response to SMC5</i></p> <p>The Council suggests adopting Option B, withdrawal of IPSAS 22. It finds that this standard requires a government presenting its consolidated financial statements to make significant restatements in order to present data for the "public sector" in the national accounting sense. Once the results have been obtained, at no small production cost, they risk duplicating the data available under the GFS reporting guidelines, even if they are not identical. In this case, the reader of the financial statements will not be fully informed.</p> <p>IPSAS 22 was intended to respond to the question of difference in scope. It seems preferable to explain the differences between the two systems by using reconciliations of clearly identified differences or written comments.</p>
023	B	<p><i>Cover letter</i></p> <p>IPSASB should curtail further development on this project until such time that it has ascertained that government users of IPSASs are highly likely to incorporate the output of this project into the preparation of their general purpose financial statements.</p> <p><i>SMC5</i></p> <p>...IPSASB should consult with the governments that have issued IPSAS based financial statements and determine why they have not adopted IPSAS 22 before expending IPSASB</p>

	Option	Selected Comments
		resources on changes to IPSAS 22.
024	C (B from preparer view)	<p>From a preparer's perspective, IPSAS 22 should be withdrawn and no new IPSAS should be issued. The arguments in paragraph 5.25 are convincing as regards the non-issuance of a new pronouncement on this, and it would be in line with comments elsewhere in this response. However, if the IPSASB were to decide to pursue this topic, a non-mandatory pronouncement outside GPFRs would be the preferred option.</p> <p>From a statistical perspective it is appreciated that IPSAS 22 has had limited success and should not continue as it is. Nevertheless there is a strong and growing demand for aggregated public accounting data, including on a "Whole of Government Accounts" (WGA) basis, for which there is no existing standard (yet it is considered as a reporting entity). Within the European Union, fiscal policy is conducted on the basis of the general government boundary, and this has been progressively reinforced in recent economic governance changes. Therefore it would be opportune to follow "Option C", both to provide a firm IPSAS basis for those jurisdictions preparing WGA, and at the same time ensuring that such WGA can be fully reconciled to a general government boundary.</p>
025	-	<i>No specific response to SMC 5 options noted.</i>

Appendix 3 Commonwealth Government of Australia – Summary of Approach to GFS Sector Disclosures

Whole of Government Financial Statements
Statement of financial performance
Statement of changes in equity
Statement of financial position
Cash flow statement

Sector Statements

	General Government Sector	Public Non-Financial Corporations	Public Financial Corporations	Eliminations and Adjustments	Whole of government
	Line-by-line consolidation of all controlled entities <u>except</u> investments in PNFC and PFC entities. Investments in PNFC and PFC entities are financial assets measured at fair value (if reliable) or carrying amount of net assets.	Line-by-line consolidation of all controlled entities in this sector.	Line-by-line consolidation of all controlled entities in this sector.		Line-by-line consolidation of all controlled entities.
Statements					
Financial performance	X	X	X	X	X
Changes in equity	X	X	X	X	X
Financial position	X	X	X	X	X
Cash flow	X	X	X	X	X

Notes on AASB 1049 requirements

Sector information may be published in the same document as the financial statements, or in another document at the same time.

Accounting policies for whole of government and all sectors must be consistent.

The policies required for statistical reporting are applied unless they conflict with the requirements of an accounting standard.

Key fiscal aggregates are to be presented on the face of the financial statements.

ISSUES PAPER: CONSOLIDATION AND USER NEEDS**Objective of the Paper**

1. The objective of this paper is to assist the IPSASB in forming a consensus view on whether there should be any exceptions from consolidation in the ED based on IFRS 10 *Consolidated Financial Statements*. It considers the usefulness of consolidated financial statements for various types of controlled entities, having regard to the characteristics of those entities and user needs in relation to those entities.
2. This paper does not contain recommendations. It is intended to inform the IPSASB's discussion of:
 - (a) Controlled entities where it is generally accepted that consolidation is the most appropriate way of meeting user needs;
 - (b) Controlled entities where there are mixed views on the usefulness of consolidation; and
 - (c) Whether there are any characteristics of entities or types of user needs that would support an exception to the principle of line by line consolidation of controlled entities (noting that investment entities are discussed separately in agenda paper 3.1).
3. The link between this paper and agenda papers 3.1 and 3.2 is as follows:
 - (a) This paper briefly discusses investment entities as a category of entities. Agenda item 3.1 considers investment entities in more detail and recommends an exception from consolidation for investment entities.
 - (b) This paper includes references to the classification of entities for the purpose of statistical reporting as these classifications are one way of identifying entities with similar characteristics. However, as noted in the paper, these classifications are not always clear cut. Agenda paper 3.2 addresses the issue of whether consolidated financial information should be required by statistical sectors at a whole of government level.

Structure of the Paper

4. The paper begins by considering entities that are closest to the influence of the executive (the part of government that has sole authority and responsibility for daily administration). It then considers categories of entities that are more distant from such influence. Categories of entities closest to the center of government are usually regarded as being controlled entities. However, as the forms of investment become more distant from government influence, decisions as to whether a specific entity is a controlled entity may depend on the facts and circumstances of that case.
5. Because types of governments and entities vary across jurisdictions there is no single classification system for government entities and the categories used in this paper can overlap. Where a term has a particular meaning for a certain jurisdiction, that jurisdiction is noted.
6. The types of entities considered in this paper are:
 - (a) Departments and ministries;
 - (b) Government agencies;
 - (c) Government Business Enterprises (GBE);

- (d) Financial institutions (excluding government sponsored enterprises); and
 - (e) Other investments (including intentional investments, incidental investments¹ and investment entities).
7. The paper focuses on users' needs for financial information in relation to *consolidated financial statements*. Information needs may also be met through other statements and reports such as (i) separate financial statements of individual entities; (ii) performance reports of individual entities or governments; and (iii) statistical reports. While the paper focuses on whole of government financial reports for a national government, the issues are also relevant when considering user needs in respect of the consolidated financial statements of state, provincial and municipal governments and also other public sector entities.
8. It is generally understood that consolidated financial statements of governments are used to demonstrate the accountability of the government for financial performance and improve fiscal transparency. They can provide valuable information to users on sustainability or a government's ability to meet existing commitments, the degree to which a government can increase its financial resources to respond to rising commitments or provide information about financial vulnerability. Although whole of government reports are generally seen as an important step in improving accountability and transparency there has been little research about who is using them or their impact on users' assessments of accountability or on decisions made by various users.

User Needs

9. This section provides an overview of user needs. The following sections consider user needs in relation to specific types of entities.
10. There is little empirical research on user needs in relation to whole of government financial statements. There is some research, but it tends to focus on the benefits of accrual information, or on consolidated financial statements in general, rather than the usefulness of consolidating different types of controlled entities when assessments are made by users holding a government to account. The recent debate in the private sector about whether or not to consolidate investment entities led to consideration of whether users' needs for fair value information about investment entities were greater than their need for consolidated information (at the investment entity level).
11. Some of the arguments made during the debate on accounting for investment entities were specific to investment entities, but other arguments are relevant to any proposal to exempt a category of entities from consolidation. The key arguments made against the investment exception from consolidation, as outlined in agenda paper 3 are:
- (a) The lack of a conceptual basis or competing principle for departing from the principle of control (general argument);
 - (b) The creation of an industry-specific exception which represents a departure from the objective of focusing on the nature of transactions (general argument);

¹ The term "incidental investments" refers to interests acquired in the course of meeting another objective, such as preventing the collapse of a private sector entity.

- (c) The argument that fair value of the investment is the most useful information to users is questionable, given the requirement to consolidate when the ultimate parent is not an investment entity (argument specific to investment entities);
 - (d) The concept of control is fundamental to determining the boundaries of a reporting entity and the preparation and presentation of financial statements (general argument); and
 - (e) Concerns about opportunities for structuring that would reduce comparability (general argument).
12. Chapter 2 of the *Conceptual Framework, Objectives and Users of General Purpose Financial Reporting*, identifies the objectives of financial reporting and user needs. The objectives are to provide information that is useful for accountability purposes and for decision-making purposes.
13. The discharge of accountability obligations requires the provision of information about the entity's management of the resources entrusted to it for the delivery of services to constituents and others, and its compliance with legislation, regulation, or other authority that governs its service delivery and other operations (*Conceptual Framework*, paragraph 2.8). The reference to "management of resources" includes information about management of controlled entities, as if resources were not tied up in these entities they could be used for other purposes. The reference to "Compliance with legislation, regulation, or other authority" encompasses information on the extent to which revenues, expenses, cash flows and financial results of government entities comply with the estimates reflected in approved budgets, and the entity's adherence to relevant legislation or other authority governing the raising and use of public monies.
14. Because of the importance of the budget in the public sector (and the importance of demonstrating compliance with the budget) some may hold the view that the budget entity should define the reporting entity. However, this would not be appropriate for general purpose financial reporting because:
- (a) Decisions about which entities are included in a government's budget may be based on factors other than the degree of autonomy of the entity and the extent to which it provides market goods or makes a commercial return.
 - (b) Decisions about which entities are included in a government's budget are often related to whether the entity's activity is intended to be self-funding. The exclusion of self-funding entities from the government's budget, essentially allows the offsetting of revenue and expenses for those activities and means that budget sector information does not reflect the substance of all transactions controlled by the government.
 - (c) The budget boundary for each jurisdiction is determined by that jurisdiction. If financial reporting were based on budget sectors there would be no comparable standardised and comparable financial reporting by governments.
15. For effective decision making users need information about the financial position, financial performance and cash flows of a public sector entity. They need this information to determine how well a public sector entity has met its financial objectives in the light of the circumstances arising in the reporting period. More specifically, users need to:
- (a) Identify the resources of the entity and claims to those resources at the reporting date;

- (b) Assess whether the entity has acquired resources economically, and used those resources efficiently and effectively to achieve its service delivery objectives;
 - (c) Assess financial performance; and
 - (d) Assess liquidity and solvency (based on *Conceptual Framework*, paragraph 2.11).
16. Although not specifically discussed in the *Conceptual Framework*, financial statements also help a reader understand financial uncertainty in a standardized and comparable way.
17. Information on compliance with the budget and other requirements is useful for accountability. However, comparisons of actual performance with budget can also provide information about how reliably a government plans, budgets, and delivers financial resources. This can be useful when assessing the stability of a government's activities.
18. Governments need to be able to deal with short-term adverse events. In considering how well a government can respond to short term adverse events without major structural or organizational change users may focus on items such as taxes, interest expense and assets and liabilities.
19. Although governments may prepare separate reports that focus on long-term sustainability, financial statements can also provide information that is useful in assessing sustainability. They can provide information that indicates how longer-term uncertainties are being managed and how prepared the entity is for long-term uncertainties. Users can consider sustainability in the context of assets, liabilities, and debt, together with related items such as capital expenditure, depreciation, and interest expense.

Qualitative Characteristics

20. The usefulness of information to users is influenced by the extent to which the information meets the qualitative characteristics (QCs). Views on the extent to which information prepared using different methods of accounting met the QCs was considered in the IPSASB's March 2013 agenda papers (refer agenda paper 7.1, March 2013).

Departments and Ministries

Typical Characteristics

21. Departments and ministries have the following typical characteristics:
- (a) Permanent or semi-permanent organization in the machinery of government that is responsible for the oversight and administration of specific functions;
 - (b) Generally not separate legal entities;
 - (c) May be separate reporting entities (but this is not the case in all jurisdictions);
 - (d) Both non-financial and financial objectives;
 - (e) Functions are regarded as core functions of government (e.g., policy advice, delivery of goods and services to the public, administration, collection of revenue, distribution of benefits);²

² However the use of functions is not a foolproof way to identify public sector entities. As noted by Lienert (2009), most spending functions performed by government are also performed by the private sector.

- (f) Despite being core functions, some departments or ministries may have significant statutory or administrative operational autonomy (for example Statistics Offices);
 - (g) Limited powers (powers may be by way of delegated authority);
 - (h) Limited ability to incur liabilities;
 - (i) Funded by public money;
 - (j) Funding approved in central budget;
 - (k) Spending monitored against budget; and
 - (l) Directly accountable to the government (usually via a Minister).
22. For the purpose of Government Finance Statistics (GFS) reporting, departments and ministries are classified as belonging to the general government sector. They are nonmarket producers (that is, entities that provide all or most of their output to others for free or at prices that are not economically significant).

User Needs

23. From a whole-of-government perspective users' needs for financial information about departments and ministries include:
- (a) Information on public money spent (in total, by function and against budget). These user needs are referred to in this paper as 'financial performance' and 'budget compliance';
 - (b) Information on assets purchased with public money and liabilities to be settled with public money. These user needs are referred to in this paper as 'assets and liabilities'; and
 - (c) Information about exposure to financial risks. These user needs are referred to in this paper as 'liquidity and solvency' and 'financial uncertainty'.
24. There are other ways that user needs could be classified, but the purpose of this paper is to consider user needs across categories of entities, not to develop a definitive classification of user needs.
25. Depending on the context, the above types of information may be used for accountability purposes or decision-making purposes, or for both purposes.

Comment

26. There is general agreement that the government controls the financial and operating policies of departments and ministries and they should be consolidated in whole of government financial statements. In the absence of consolidated financial statements users cannot get an overview of government spending or an overview of the balance and composition of assets and liabilities. The level of support for consolidated information on ministries and departments is consistent with the fact that they are regarded as part of the core government.
27. Draft ED X, *Consolidated Financial Statements*, would require that ministries and departments be consolidated. It states that control can be demonstrated by being able to determine the other entity's operating and financing policies.

Government Agencies

Typical Characteristics

28. Government agencies have the following typical characteristics:
- (a) Permanent or semi-permanent organization in the machinery of government that is responsible for the oversight and administration of specific functions;
 - (b) Separate legal entities;
 - (c) Not a department or ministry;
 - (d) May have corporate form (but are not GBEs);
 - (e) Mainly non-financial objectives;
 - (f) Likely to be funded, at least partially, by government, although some government agencies may be self-supporting, or generators of revenue (e.g. Lotteries Bodies). The power to charge user fees is likely to be regulated; and
 - (g) Autonomy, independence and accountability vary. Some entities may have significant independence in relation to operating activities. Financing activities are likely to be constrained however.
29. For the purpose of GFS reporting, these types of government agencies may be referred to as extra-budgetary organizations. Within statistical reports they may be classified as belonging to the general government sector or to the public corporations sector. However, entities with the characteristics referred to above would normally be classified as general government because they would normally be nonmarket producers (that is, entities that provide all or most of their output to others for free or at prices that are not economically significant).

User Needs

30. Despite the fact that they are generally separate legal entities, government agencies are often responsible for carrying out key government activities and are subject either to close oversight by the government or to intervention if there is concern about how they are using their autonomy. Because of this, user needs are likely to be the same as for government departments and ministries. This conclusion is also likely to hold where:
- (a) Government agencies are financed from market revenue as the amount of revenue or sources of revenue are likely to be regulated.
 - (b) Government agencies have operational autonomy as (i) that autonomy is likely to be limited; (ii) governments frequently have the capacity to hold agencies to account for non-performance; and (iii) a governments, in turn, is likely to be held to account for monitoring the performance of the agency and exercising its powers over the agency.

Comment

31. There is general agreement that if the government controls the financial policies of government agencies and sets the strategic operating parameters under which they operate, the agencies should be consolidated in whole of government financial statements.

32. Draft ED X, *Consolidated Financial Statements*, would require that government agencies be consolidated. The government is exposed or has rights to variable benefits from its involvement with government agencies and it has the ability to affect the nature and amount of those benefits through its power over those agencies (typically through its ability to determine the agencies' operating and financing policies).

Government Business Enterprises

Typical Characteristics

33. A GBE is defined in IPSASs as having all of the following characteristics:
- (a) Power to contract in its own name.
 - (b) 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.
 - (d) Not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length).
 - (e) Controlled by a public sector entity.
34. Although the IPSASB is currently reviewing the definition of a GBE, the above definition is sufficient for the purposes of this paper in that it describes a group of entities that generally have a corporate form and commercial objectives.
35. GBEs are generally required to apply financial reporting standards other than IPSASs. GBEs are more removed from government influence than departments and government agencies. Depending on the jurisdiction similar types of entities may be referred to as government-owned corporations, state-owned companies, state-owned entities, state enterprises, publicly owned corporations, commercial government entities, public sector undertakings and parastatals. These entities may or may not meet all the characteristics of a GBE. They generally have commercial objectives but their level of autonomy will vary widely both within and between jurisdictions.
36. As a generalization, GBEs tend to be created by a government rather than acquired. National airlines are an exception to this generalization. Financial institutions, entities in which the government acquires an interest and investment entities are discussed separately in this paper.
37. For the purpose of GFS reporting, most GBEs will be classified as public non-financial corporations (although some could be financial corporations)³. They are market producers (that is, entities that provide all or most of their output to others at prices that are economically significant).

User Needs

38. From a whole of government perspective users' needs for financial information include information about:
- (a) Financial performance. This includes information on the collective amount of subsidies to GBEs and whether GBEs as a sector are profitable;

³ Financial institutions are discussed separately below.

- (b) Budget compliance. This includes information on budget versus actual spending in relation to any subsidies provided and the use of public money to finance the capital expenditure of a GBE. The obligation to be accountable for such spending may however be met by the grantor (being a ministry or department or other central government agency) rather than by the GBE receiving the money.
- (c) Assets and liabilities: This includes information on the overall financial position of the government, including the collective level of GBE assets and liabilities and movements in those assets and liabilities.
- (d) Liquidity and solvency.
- (e) Financial uncertainty.

Comment

- 39. Consolidated financial statements are useful for governments which have interests in a large number of publicly-owned companies, because they present an overview of the government's financial performance and position. For example, they show information on the composition of assets and liabilities and the relative reliance on various types of revenue. GBEs are often responsible for managing activities that involve large investments in infrastructure. Users need consolidated financial statements in order to see the magnitude of the government's investment in infrastructure assets and how that investment has been financed.
- 40. Governments also have discretion in determining the composition of a GBE's statement of financial position, including the proportion of borrowing to equity. Because fiscal targets such as debt to GDP ratios do not generally include the debt of all controlled entities, governments can structure activities in a way that affects the assessment of fiscal targets. In contrast, consolidated financial statements give a "panoramic view" that shows total debt across all controlled entities. Users can best assess the prudence of debt levels if all debt is shown, rather than a subset that excludes the debt of commercial operations.
- 41. The statistical community has noted the difficulties of distinguishing commercial from non-commercial activities, market from non-market activities and which entities should be classified as public sector entities. For example, Lienert (2009)⁴ makes the following points:
 - (a) With increasing use by governments of market mechanisms and private sector provision of public services, the border between the public and private sectors often appears blurred.
 - (b) It is not possible to delineate the public and private sectors solely on functional grounds, since nearly all functions undertaken by government are also performed by the private sector.
 - (c) The concept of ownership is crucial for defining the public and private sectors. Economic ownership is exercised by a controlling entity when it has the power to govern the financial and operating policies of the other entity.
 - (d) While a legal approach and the use of statute can provide clarity, law does not provide an internationally-acceptable definition of the two sectors.

⁴ Lienert, Ian, 2009, IMF Working Paper WP/09/122 *Where Does the Public Sector End and the Private Sector Begin?*

- (e) Boundary problems within the public sector are particularly acute, because of ambiguities in distinguishing “market” from “nonmarket” activities, and the ability to shift activities between sectors.
 - (f) What appears to be a gray zone between the public and private sectors can be split into component parts and measured without ambiguity, but this tends to require the use of rules that contain a degree of arbitrariness.
42. With reference to the market/non-market classification, rather than there being a clear split between the two categories there is likely to be a spectrum of expectations about the return that activities might generate (moving from very commercial to very non-commercial). The distinction between market and non-market also relies on a judgment about the significance of prices in impacting on demand. The classification of entities as market/non-market by reference to an economic concept such as the relationship between prices and changes in demand would not necessarily be consistent with how those entities are regarded for financial reporting purposes. For example, monopoly suppliers could be classified as non-market for statistical reporting purposes but would often have commercial objectives that are similar to other government trading activities. The point of this discussion is not to query the classification of specific entities for statistical reporting to but to show that there is not always a clear distinction between market and non-market and that this approach would have implications for comparability in the context of general purpose financial reporting.
43. Although IPSAS 6 currently requires that all controlled entities, including GBEs, be consolidated, many jurisdictions do not do so. Reasons given for not consolidating GBEs vary. Accounting options other than consolidation include equity accounting and fair value.
44. Conceptual arguments for supporting equity accounting in whole of government statements include:
- (a) Equity accounting permits a focus on the assets and liabilities used in core government activities (with GBEs being outside that core);
 - (b) Equity accounting provides cost-based information on the financial performance of certain investments; and
 - (c) Equity accounting shows the net cost-based investment in certain investments.
45. Others have adopted equity accounting for pragmatic reasons as it is both quicker and less expensive than full consolidation. If consolidation is being implemented in phases, the consolidation of GBEs (and similar entities) is often deferred until the consolidation of departments and government agencies is complete. For example, in the case of a phased consolidation process in Georgia, GBE consolidation was deferred because the (i) GBE financial statements were not yet fully IFRS compliant; (ii) there was insufficient information available for consolidation; and (iii) information was not available on a timely basis for consolidation.⁵
46. Fair value is the other main accounting option that could be considered for accounting for GBEs in whole of government financial statements. Fair value would provide a current measure of the government’s investment in GBEs. However, as noted by the IPSASB in March 2013, it is often difficult or expensive to estimate fair value for public sector investments. In addition, unless a

⁵ Tchelishvili, Nino, April 2011, *Accounting Reform and IPSAS Implementation in Georgia*
<http://www.pempal.org/data/upload/files/2011/04/georgia-ipsas-implementation-ljubljana.pdf>

government has embarked on a privatization program, GBEs tend to be held with the intention of long-term public ownership, and thus the relevance of a fair value measure to assessments of operational or commercial capacity provided by the investments is limited.

47. This section has noted general arguments for and against consolidation of GBEs. However, the benefits of consolidation may be influenced by the relative size of the government. The Swedish Council of Municipal Accounting issued a recommendation that local governments prepare consolidated financial statements (including the consolidation of municipality companies). Karlsson and Nilsson (2010)⁶ concluded that Swedish municipalities were more inclined to implement the recommendation to consolidate if they were of a larger size, with a high performance, with a high tax income and with large municipal companies.

Financial Institutions

48. It is quite common for governments to own banks, insurance companies and other financial institutions. In some cases these investments have been intentional, possibly because of market failure to provide similar services or the government's desire to use these institutions to accomplish social objectives (for example, to provide finance to a disadvantaged sector of the community). In other cases the government obtains a financial interest in an entity as a result of an intervention to prevent the failure of a private sector financial institution. Both result in the government having an investment in another entity. However there are differences.
49. The former category (intentional investments) are more likely to be linked to a government's objectives against which the government should be held to account, and more likely to be regarded as medium to long term investments. The latter category (incidental investments) are less likely to be linked to a government's specific objectives (although they will be linked to broad objectives such as economic stability) and are more likely to be regarded as short term investments.

Typical Characteristics

50. A financial institution is an establishment that conducts financial transactions such as investments, loans and deposits. Financial institutions include:
- (a) Commercial banks;
 - (b) Investment banks;
 - (c) Insurance entities;
 - (d) Investment entities; and
 - (e) Other entities that have specific responsibilities relating to the management and investment of significant public financial assets (as discussed in agenda paper 3.1, some of these entities may meet the definition of investment entities).
51. Commercial banks deal with the general public whereas investment banks deal with corporates. The functions of investment banks include underwriting debt and equity offerings, acting as an

⁶ Karlsson, J. and Nilsson, M., 2010, *An alternative approach to IPSAS consolidation : The case of Sweden*, University essay from Högskolan Kristianstad/Sektionen för Hälsa och Samhälle; Högskolan Kristianstad/Sektionen för Hälsa och Samhälle. There were some differences between the Swedish recommendation and IPSAS 6. The conditions under which consolidation was recommended differed and proportionate rather than full consolidation was recommended.

intermediary between an issuer of securities and the investing public, making markets, facilitating mergers and other corporate reorganizations, and acting as a broker for institutional clients. They may also provide research and financial advisory services. Generally speaking, investment banks are subject to less regulation than commercial banks. Most financial institutions are regulated by the government. Often the regulator is the central bank.

52. GFS defines financial corporations as institutional units that are principally engaged in financial services including financial intermediation. Financial corporations are then classified as either public financial corporations or private financial corporations depending upon which sector controls them.
53. Examples of public financial institutions and the sectors they were involved in as at 2006 are shown in Table 1 below. This paper does not address the issue of whether central banks are controlled entities. Most, but not all, jurisdictions regard central banks as not being controlled entities.

Table 1 Examples of Public Financial Institutions

	Housing	SME/Innovation	Agriculture
United States	Fannie Mae/Freddie Mac, Federal Home Loan Banks	Small Business Administration Credit Guarantees Program	Farm Credit System
Canada	Canada Mortgage and Housing Corporation	Business Development Bank of Canada Canada Small Business Financing Program	Farm Credit Canada
United Kingdom		Small Firms Loan Guarantee Program High Technology Fund/Regional Venture Capital Funds	
Germany	KfW Foerderbank	KfW Mittelstandsbank	
Japan	Japan Housing Loan Corporation	National Life Finance Corporation, Japan Finance Corporation for Small and Medium Enterprise Shoko Chukin Bank Development Bank of Japan	Japan Agriculture Finance Corporation

Source: Ratnovski, Lev and Narain, Aditya, 2006, IMF Working Paper WP/07/227 *Public Financial Institutions in Developed Countries—Organization and Oversight*.

54. Some of these financial institutions are hybrid in nature and may or may not be controlled for the purposes of financial reporting. For example, Government Sponsored Enterprises (GSEs) in the United States of America were created to make credit more readily available to certain sectors of the economy. GSEs typically have four characteristics:
- (a) Private ownership;
 - (b) Implicit federal guarantee of obligations;
 - (c) Activities limited by congressional charter; and
 - (d) Limited competition.
55. Assessments as to whether hybrid entities such as GSEs are controlled will vary depending on the application of a specific accounting standard to the facts and circumstances of each case.

Financial Institutions and Government Interventions

56. In recent times governments have intervened in a number of ways to provide support to private sector financial institutions. Some of these interventions have led to governments obtaining financial interests in these institutions, and in some cases they have led to governments obtaining control for the purposes of financial reporting. As with hybrid entities, assessments of control depend on which accounting standards are applied and the facts and circumstances of each case.
57. Types of interventions and the ways in which governments have accounted for them have been discussed by Bergmann.⁷ Eurostat has also published information about the impact of interventions on key statistical measures.⁸ This paper is not concerned with how governments have accounted for the interventions but rather which interventions could give rise to control for financial reporting purposes and some of the arguments for and against consolidation when control arises in these circumstances.
58. Table 2 below lists various forms of interventions, and the possible impact of an intervention on a government's financial statements (including the possibility of the intervention giving rise to control for financial reporting purposes). The possible accounting impacts have been simplified for the purposes of illustration. In practice there could be a number of transactions associated with such interventions. Table 2 focuses on the treatment in financial statements. Eurostat has described these terms and considered the treatment of interventions on government finance statistics in the European Union (EU).^{9,10}

⁷ Bergmann, Andreas, *Accounting for Government Interventions in the Corporate Sector, Consolidation to be Revisited*, in *Jahrbuch der Schweizerischen Verwaltungswissenschaften*, edited by Schweizerische Gesellschaft für Verwaltungswissenschaften, Berne 2011, pages 51-60

⁸ Eurostat, *Statistics in Focus*, 10/2013

⁹ Eurostat, *Bank recapitalisation in government finance statistics*

http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Bank_recapitalisation_in_government_finance_statistics

¹⁰ Eurostat, October 2012, *EUROSTAT Supplementary Table for the Financial Crisis, Background note*

Table 2 Forms of Intervention

Intervention	Possible impact on government's separate financial statements	Possible impact on government's consolidated financial statements
<u>Recapitalization</u> occurs when an equity instrument issued by a financial institution is acquired by government and may involve a wide range of various instruments, including ordinary shares, preference shares and hybrid debt-equity instruments	Capital injections may be treated as expenses (capital transfers in statistical terms) or as an acquisition of equity, or a mixture of the two. The amount recognized as an asset is constrained by IPSAS 29. Capital injections may be financed in a variety of ways including increased taxes, asset sales and borrowing.	If the government controls the financial institution, the investment in the financial institution would be replaced by the assets and liabilities of the financial institution. Any goodwill on acquisition would be written off over time.
<u>Guarantees</u> provide an assurance that should a debtor be unable to meet its liability, the guarantor will meet the liability. For financial institutions this includes government guarantees on deposits and on borrowing. In the context of the financial crisis, some governments also extended significant guarantees to the value of bank assets.	The guarantee may need to be recognized as a liability. If the guarantee is not required to be recognized as a liability it is disclosed in the notes.	Assume entity to whom guarantee was provided is not controlled. Amounts in separate financial statements flow through to consolidated statements (any inter-entity balances are eliminated).
<u>Purchases of assets</u> commonly involve acquisitions by government of equities and securities other than shares (bonds), and also, in some cases, of loans.	The amount recognized as an asset is constrained by the relevant accounting standard. Any excess over the amount that may be recognized under the accounting standard would be an expense.	Not relevant.
<u>Loans</u>	The amount recognized as a financial asset is constrained by IPSAS 29. There may be an expense if the loan is not likely to be repaid or is on rates more favorable than market rates.	Assuming the entity to whom the loan was provided is <u>not</u> controlled, the loan would be included in the government's separate and consolidated statements.
<u>Defeasance</u> : the government buys impaired assets from financial institutions, or creates a separate body to undertake this task. Problematic assets may be allocated to a public entity that is created through the restructuring of an existing financial institution.	Depends on how the transaction is structured. The government's rights may be linked to equity instruments or debt instruments.	If the government is assuming the majority of the risks the government may control the entity. If control exists the investment in the defeased structure would be replaced by the assets and liabilities of the defeased structure.

Intervention	Possible impact on government's separate financial statements	Possible impact on government's consolidated financial statements
<u>Liquidity operations conducted through exchange of assets:</u> an asset is exchanged for another (different) asset, commonly over a fixed period of time. Examples include repurchase agreements and securities lending.	Under a repurchase agreement the composition of assets would change. There may also be additional borrowing to finance the acquisition.	Assume not controlled.
<u>Creation of temporary special purpose entities.</u> See also Defeasance.	Depends how the transaction is structured. The government may not have an equity interest in the entity. It may have given guarantees or have entered into agreement to buy goods and services or assets at a future date.	The entity may be controlled. If it is controlled, the assets and liabilities of the entity would be brought into the consolidated financial statements. If it is not controlled it may meet the definition of a structured entity and disclosures may be required.

User Needs

59. Users want to be able to assess whether there has been good governance of government controlled financial institutions. Poor governance can impact on public sector liabilities, inefficiencies and resource misallocation. With respect to government interventions users want to know the cost of those interventions, the impact on the government's financial performance and financial position and the ongoing exposure to financial risk.

Comment

60. There are mixed views as to the usefulness of consolidating financial institutions in whole of government financial statements.¹¹
61. Arguments for consolidation of all controlled financial institutions include:
- (a) Accounting standards should be principles based. All controlled entities should be consolidated.
 - (b) Consolidated financial statements give an overview of the assets and liabilities that are ultimately under the government's control and the government's exposure to changes in revenues and expenses associated with various activities.
 - (c) Any exception from consolidation provides structuring opportunities. Government's assets and liabilities, including their exposure to financial risks, should be reported consistently, regardless of the way in which control is exercised. For example the allocation of impaired

¹¹ This paper considers only the arguments made at a whole of government level. These arguments are not necessarily the same as those that would apply when considering the usefulness of consolidating financial institutions controlled by another public sector entity other than a government.

assets to an existing controlled financial institution and the creation of a separate entity to hold impaired assets should be accounted for consistently.

- (d) Any exception from consolidation is difficult to apply in a consistent manner.
- (e) Consolidation enhances comparability. The way in which a government engages in activities varies between countries and can change over time.

62. Arguments against consolidation of all controlled financial institutions include:

- (a) The expense of consolidating all controlled entities, particularly where there is a high number of government owned companies.
- (b) Where control is intended to be temporary the cost of preparing consolidated financial statements is not justified. (Although IPSAS 6 currently has an exception from consolidation for temporarily controlled entities, the IPSASB has expressed concerns about this approach and agreed not to include an exception for temporary control in the ED based on IFRS 10.)
- (c) The size of financial institutions can swamp the underlying financial information of a government.
- (d) The composition of the assets and liabilities of financial institutions are so different from other government activities (typically they have high levels of financial assets and financial liabilities and low levels of net assets/equity) that it does not make sense to add them together.
- (e) In the case of financial institutions that are investment entities the argument is that users use fair value to assess performance.

Other Investments

- 63. Governments may have investments in a wide range of other activities including manufacturing activities, agricultural activities, tourism etc. Such investments may have been made because of market failure or because they represent a way of promoting the government's social policy objectives.
- 64. The arguments for and against consolidation are very similar to those outlined for financial institutions. However, the nature of the assets and liabilities, revenue and expenses, and exposure to financial risk will depend on the nature of the activity.

Current Practice

- 65. A summary of reporting practices of a selection of governments (as at 2012) is set out in Table 3 below. This illustrates some of the variations in current practice. Although it is interesting to note current practice, accounting standards are developed by reference to the conceptual framework.

Table 3 Scope of Financial Reports of Seven Governments (as at 2012)

Country	Reporting Entity and Consolidation	State-Owned Enterprises	Central Bank	Local Govt	Selected Other Exclusions
Iceland	Central government	No	No	No	
Australia	Central government and entities it controls	Yes	Yes	No	
Canada	Central government and financially dependent entities it controls	Some	No	No	
France	Central government	No	No	No	
New Zealand	Central government and entities it controls	Yes	Yes	No	
Sweden	Central government	No	No	No	
United Kingdom	Public sector bodies that exercise public functions or are substantially funded from public money	Yes	Not yet	Yes	Rescued banks
United States	Central government	Some	No	No	Rescued financial institutions

Source: Financial statements of relevant governments, as presented in IMF Country Report No. 12/4 (2012), *Iceland: Technical Assistance Report on a New Organic Budget Law*.

Note: The United Kingdom had indicated its intention to consolidate the central bank in 2012.

Recommendations

66. This agenda paper is for information and discussion. It does not contain recommendations. The overall recommendations in respect of this item are set out in the memo at agenda item 3.