PEMPAL TCoP

Thematic Working Group on Consolidation

Summary of Main Requirements of IPSAS Board Exposure Drafts on Consolidation

February 2014

The relevant Exposure Drafts

The International Public Sector Accounting Standards (IPSAS) Board issued in October 2013 the following Exposure Drafts (EDs) relating to Consolidation:

- **ED48**: Separate Financial Statements
- **ED49**: Consolidated Financial Statements
- **ED50**: Investments in associates and Joint Ventures
- **ED51**: Joint Arrangements
- **ED52**: Disclosure of Interest in Other entities

For all of the above Exposure Drafts the consultation period ends on February 28, 2014. It is likely the EDs will form the basis of new IPSAS issued later in 2014.

For TCoP members the most important of the above are EDs 48 and 49, which will replace IPSAS 6 on Consolidation. The main requirements of these EDs and the changes from IPSAS 6 are explained below.

It is important to recognise that these are Exposure Drafts issued for discussion and comments. The requirements may change before the EDs become IPSAS.

ED48: Separate Financial Statements

ED48 has been issued as a separate Exposure Draft, but the requirements are very similar to those in the existing IPSAS 6. As indicated above, EDs 48 and 49 will be combined in a new IPSAS to replace IPSAS 6.

The scope is defined as follows:

Para 2: *"An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for investments in controlled entities, joint ventures and associates when it elects, or is required by regulations, to present separate financial statements."*

Thus there are two situations where ED48 applies:

- An entity produces consolidated financial statements, but is in addition required by law to prepare its own 'unconsolidated financial statements', or
- An entity is one of the exceptions allowed in ED49 and is not required to produce consolidated financial statements, e.g. a Sovereign Investment Fund or a Ministry where there are 'whole of government' financial statements. In such cases the entity must prepare 'unconsolidated financial statements'.

In both these situations ED48 applies to the unconsolidated financial statements of the entity. ED48 imposes requirements in addition to the requirements of other IPSAS.

Accounting for investments in controlled entities

According to Para 12 of ED48 such investments will be accounted for:

i. *Using the equity method (in ED50), or*
ii. *At cost, or*
iii. *In accordance with IPSAS 29 (note that this is the only acceptable valuation basis for entities controlled by an investment entities)*

The same accounting should be used for all investments in each category.

Note that this is different to the valuation method in the Government Finance Statistics (GFS) Manual 2001. The latter requires valuation at market value if possible, or otherwise at cost.

Disclosure

Where separate financial statements of the controlling entity are prepared the following information must be disclosed:

Para 20: *"The fact that the financial statements are separate financial statements; that the exemption from consolidation has been used; the name of the entity whose consolidated financial statements that comply with IPSASs have been produced for public use; and the address where those consolidated financial statements are obtainable.*

(a) A list of significant investments in controlled entities, joint ventures and associates, including:

i The name of those controlled entities, joint ventures and associates.

ii The jurisdiction in which those controlled entities, joint ventures and associates operate (if it is different from that of the controlling entity)

(b) Its proportion of the ownership interest held in those entities and a description of how that ownership interest has been determined.

(c) A description of the method used to account for the controlled entities, joint ventures and associates listed under (b)"

These requirements are similar to the existing requirements in IPSAS 6.

ED49: Consolidated Financial Statements

General requirement for consolidated financial statements

As with IPSAS 6 the requirement is that "***An entity that is a controlling entity shall present consolidated financial statements***" (Para 5). There are two exceptions in ED49 to the requirements for consolidated financial statements that concern the Consolidation Working Group.

Exception 1 - an intermediate consolidation entity need not present consolidated financial statements where:

- *The entity is itself a controlled entity and the information needs of users are met by the controlling entities consolidated financial statements, and*
- *Its debt or equity instruments are not traded in a public market, and*
- *It does not file its financial statements with a securities commission or equivalent.*

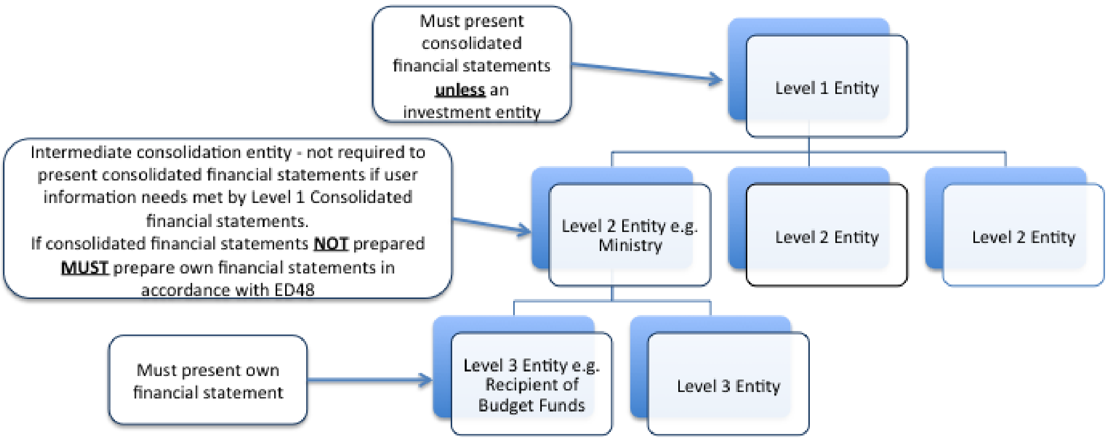
Hence a Government Ministry need not consolidate the financial accounts of its subsidiary organisations if all are consolidated within whole of government financial statements. However, the overriding requirement is to meet the information needs of users.

Exception 2 - "*An investment entity reporting in accordance with IPSASs need not present consolidated financial statements if it is required, in accordance with paragraph 52 of this Standard, to measure all of its controlled entities at fair value through surplus or deficit"*

An investment entity is defined as an entity that *(i) obtains funds from investors for the purpose of providing those investors with management services (ii) invests solely for the purpose of obtaining returns from capital appreciation and revenue, and (iii) measures and evaluates the performance of its investments on a fair value basis.* According to Para 52, an investment entity shall measure an investment in a controlled entity at fair value through surplus or deficit in accordance with IPSAS 29.

An overview of the exceptions and requirements for separate financial statements is provided in the diagram below.

Figure 1: Overview of Consolidation requirements



Changes from IPSAS 6

- The second exemption (investment entity) does not exist in IPSAS 6 and hence is a new exception to the requirement to prepare consolidated financial statements.
- The existing exemption in IPSAS 6 Para 20 where control is temporary is removed in ED49.

Control as the basis for defining the consolidation entity

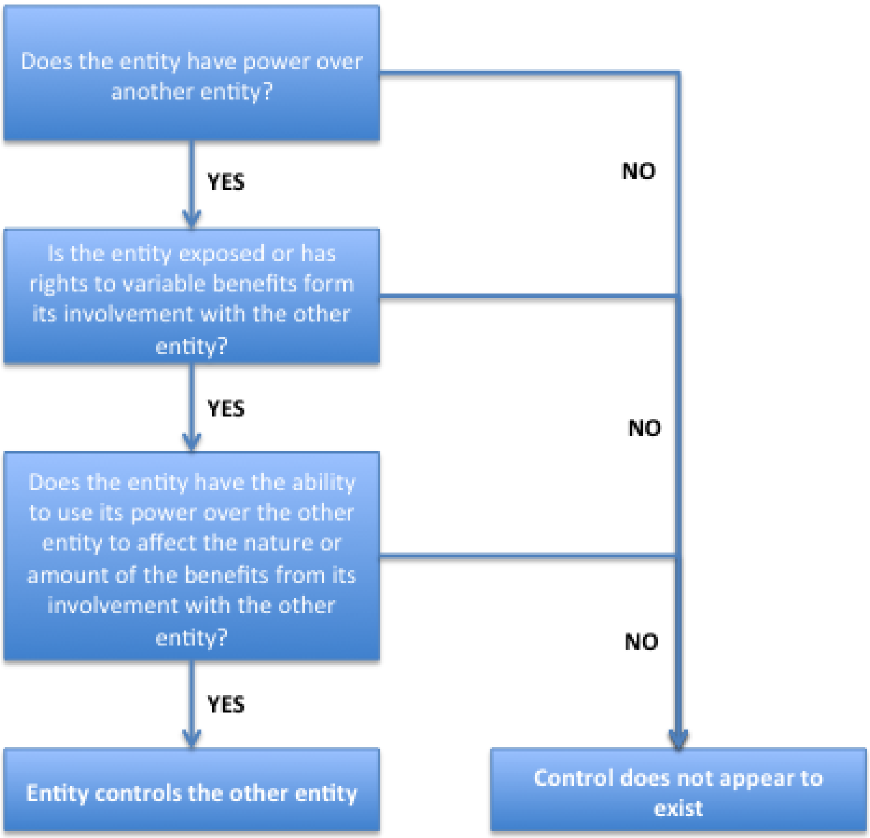
The concept of defining the consolidation entity on the basis of control is retained. This is different to the GFS approach, where the consolidation entity is defined as the General Government Sector (GGS) - an administrative definition.

The proposed definition of contra in ED49 is changed from IPSAS 6. The new proposed definition is more complex. The new definition has three requirements, which must all be met to determine control. The new requirements summarised in the matrix below.

Proposed requirements in ED49 which must ALL be met to determine control	**Explanation**
1. Power over the other entity	Ability to direct activities of the entity - from voting rights, laws or regulations. Regulatory control or economic dependence does not necessarily amount to control for the purpose of the ED - there must be the ability to direct activities.
2. Exposure, or rights, to variable benefits from its involvement with the other entity	Benefits may be financial or non-financial. Non-financial include benefits to service recipients of the entity
3. The ability to use its power over the other entity to affect the nature or amount of the benefits from its involvement with the other entity	The controlling entity must be able to use its power to affect the nature or amount of the benefits from its involvement with the entity being assessed for control.

In IPSAS6 there is a decision tree explaining the concept of control. There is no equivalent decision tree in ED49. The model below uses the format of IPSAS 6 but is based on the requirements as specified in ED49.

Figure 2: Decision Tree for determining control under ED49



Changes from IPSAS 6

The three level definition of control is similar to that used in IPSAS 6, paragraphs 37 to 42, but the wording used to describe each of the three requirements has been changed and made more precise.

Consolidation procedures

The requirements for uniform accounting policies, the same reporting date and the consolidation procedures are unchanged from IPSAS 6.

Para 34: *"A controlling entity shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances. "*

Para 36: "*Consolidated financial statements:*

(a) *Combine like items of assets, liabilities, net assets/equity, revenue, expenses and cash flows of the controlling entity with those of its controlled entities.*
(b) *Offset (eliminate) the carrying amount of the controlling entity's investment in each controlled entity and the controlling entity's portion of*

net assets/equity of each controlled entity (the relevant international or national accounting standards explain how to account for any related goodwill).

(c) *Eliminate in full intra-economic entity assets and liabilities, net assets/equity, revenue, expenses and cash flows relating to transactions between entities of the economic entity (surpluses or deficits resulting from intra-economic entity transactions that are recognized in assets, such as inventory and fixed assets, are eliminated in full). Intra-economic entity losses may indicate an impairment that requires recognition in the consolidated financial statements."*

Para 42: "*The financial statements of the controlling entity and its controlled entities used in the preparation of the consolidated financial statements shall be prepared as at the same reporting date."*

ED50: Investments in Associates and Joint Ventures

ED 50 addresses the valuation of investments in entities that are not controlled entities but are either associates or joint ventures as defined in ED. It is presumed that this will lead to a new IPSAS to replace the existing IPSAS 7.

The equity method as described in ED 50 is also one of the bases for valuation of controlled investments allowed in ED48, paragraph 12 (see above).

Para 8 (definitions): "*The equity method is a method of accounting whereby the investment is initially recognized at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets/equity of the associate or joint venture. The investor's surplus or deficit includes its share of the investee's surplus or deficit and the investor's net assets/equity includes its share of changes in the investee's net assets/equity that have not been recognized in the investee's surplus or deficit.*"

The other contents of ED50 are not considered relevant to the Consolidation Working Group.

ED51: Joint Arrangements

This Exposure Draft deals with the specific situation of joint control of an arrangement. There is no current IPSAS dealing exclusively with the issues in this ED.

The contents of ED51 are not considered relevant to the Consolidation Working Group.

ED52: Disclosure of Interest in Other Entities

Para 2 defines the scope of ED 52: "*An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in disclosing information about its interests in controlled entities, unconsolidated controlled entities, joint arrangements and associates, and structured entities that are not consolidated.* "

Therefore ED52 defines the disclosure requirements for consolidated financial statements. These are currently contained in IPSAS 6.

ED52 introduces a new concept of "Structured Entities' and requires disclosure of information about such entities. The definition of structured entities in the ED is convoluted. In essence these are entities where there are binding contractual arrangements that override the normal determinants of control. ED52 also applies to such structured entities, but these are not relevant for the Consolidation Working Group.

The disclosure requirements are extensive and include disclosures about joint arrangements and associates. The main requirements in relation to controlled entities are summarised as follows:

Para 9(a)(i): Significant judgements and assumptions made in determining the nature of the interest in another entity

Para 9(b)(i): Information about interests in controlled entities

Para 12(a): Methodology used to determine control

Para 17: Interest in controlled entities - composition, minority interests, restrictions, risks, consequences of changes in control

The above information may be aggregated and presented for groups of controlled entities.

Conclusions on the Exposure Drafts 48 to 52

The Exposure Drafts propose much more extensive guidance and rules on issues relating to consolidation and the reporting on controlled and associate entities. There are a number of significant changes from the current standards as indicated above.

However, there are no changes of principle, and the main differences from the requirements of GFS remain:

(a) The consolidation entity: IPSAS is based on control, GFS on the administrative definition of the General Government Sector

(b) Different (though similar in principle) definitions of control

(c) Different rules for measuring the value of investments.

These differences will continue to cause problems for countries establishing a uniform system of accounting to meet GFS (or ESA) and IPSAS reporting requirements.