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on 28-29 April 2021, starting at 10:00

Item 5 of the Agenda

Draft EPSAS Screening Report
IPSAS 38 – Disclosure of interests in other entities

Paper by PwC in cooperation with Eurostat

- for discussion -

This document was commissioned by Eurostat. It analyses the consistency of the named IPSAS standard with the draft EPSAS framework, with a view to informing future EPSAS standard setting. This version was prepared taking into account comments received from the participants of the Cell on Principles related to EPSAS Standards.

EPSAS screening report

IPSAS 38 - Disclosure of Interests in Other Entities

May 2021

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Background

Objectives

Reference is made to the general introduction to the EPSAS screening reports that covers the following elements:

- Key objectives of EPSAS.
- Standard setting process in the public sector.
- Purpose and scope of the screening reports.
- Approach of the screening reports.
- European public good.
- Common elements considered when preparing the reports.

General introduction to IPSAS 38

IPSAS 38 is drawn primarily from International Financial Reporting Standard (IFRS) 12 ‘Disclosures of interests in other entities’, published by the International Accounting Standards Board (IASB). In developing IPSAS 38, the International Public Sector Accounting Standards Board (IPSASB) applied its ‘Process for Reviewing and Modifying IASB Documents’ that identifies public sector modifications where appropriate. This approach enables the IPSASB to build on best practices in private sector financial reporting, while ensuring that the unique features of the public sector are addressed.

The objective of the IPSAS 38 standard is to require an entity to disclose information that enables users of its financial statements to evaluate (IPSAS 38 para 1):

(a) the nature of, and risks associated with, its interests in controlled entities, unconsolidated controlled entities, joint arrangements and associates, and structured entities that are not consolidated; and

(b) the effects of those interests on its financial position, financial performance and cash flows.

IPSAS 38 should be applied in disclosing information about qualifying interests. An interest in another entity refers to an involvement by way of binding arrangements or otherwise that exposes an entity to variability of benefits from the performance of the other entity.

Some disclosures of IPSAS 38 have been carried forward from existing IPSASs without a significant change, as IPSAS 38 replaces the disclosure requirements of ‘IPSAS 6 ‘Consolidated and separate financial statements’, IPSAS 7 ’Investments in associates’ and IPSAS 8 ‘Interests in joint ventures’.

IPSAS 38 extends the disclosure requirements about significant restrictions on a parent's ability to access or use the assets and settle the liabilities of its subsidiaries. IPSAS 38 includes new elements of disclosure requirements regarding unconsolidated structured entities, significant judgements and assumptions, interests in subsidiaries with material non-controlling interests, consolidated structured entities and interests in joint arrangements and associates.

Scope of the report

The International Public Sector Accounting Standards Board (IPSASB®) issued IPSAS 38 'Disclosure of interests in other entities' in January 2015.

The standard deals with the disclosure requirements relating to the interests that the entity holds in other entities.

Reference to EFRAG assessment

IASB issued IFRS 10 'Consolidated financial statements', IFRS 11 'Joint arrangements', IFRS 12 'Disclosure of interests in other entities', IAS 27 'Separate financial statements' (2011) and IAS 28 'Investments in associates and joint ventures' (2011) on 12 May 2011. On 30 March 2012, the EFRAG provided its opinion on those.

EFRAG has considered whether IFRS 12 meets the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002, in other words that IFRS 12:

(a) is not contrary to the principle of 'true and fair view' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

(b) meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG also considered whether it would be not conducive to the European public good to adopt IFRS 12 and it concluded that it is in the European interest to do so.

On 22 July 2015, EFRAG submitted its Endorsement Advice relating to investment entities 'Applying the consolidation exception' (amendments to IFRS 10, IFRS 12 and IAS 28)' for use in the European Union and European Economic Area. EFRAG assessed that the amendments meet all technical endorsement criteria of the IAS Regulation and are conducive to the European public good.

Reference to EPSAS issue papers[1]

The PwC study of 2014[2] analysed the suitability of the IPSAS standards as a basis for developing EPSAS. This included the analysis of 'IPSAS 6 'Consolidated and

[1] EPSAS Issues papers are available on https://ec.europa.eu/eurostat/web/epsas/key-documents/technical-developments
[2] Collection of information related to the potential impact, including costs, of implementing accrual accounting in the public sector and technical analysis of the suitability of individual IPSAS standards (Ref. 2013/S 107-182395)

separate financial statements', IPSAS 7 'Investments in associates' and IPSAS 8 'Interests in joint ventures'. The disclosure requirements of these standards were replaced by IPSAS 38. In general, following this analysis, no major comment has been made by Member States on IPSAS 7 and IPSAS 8, but the requirements included in these standards may potentially be impacted by the discussions on IPSAS 6 as some of the principles of these standards are linked to each other. The most important concern related to the definition of the scope of consolidation and the application of the control concept in IPSAS 6, IPSAS 7 and IPSAS 8 were classified under category 3 'Standards that might be implemented with minor or no adaption'.

In the course of developing the technical proposal on EPSAS, Eurostat commissioned a series of twenty technical issues papers (IPs), which analyse in particular key public sector specific accounting issues. The papers were discussed at the EPSAS Working Group meetings during 2016-2018. The papers are all publicly available on Eurostat's website.

Each of the IPs seek to identify conclusions and key issues for further discussion. Taking into consideration the analyses provided in the IPs and the initial views exchanged with Member States' public sector accounting experts during the Working Group meetings, Eurostat drew tentative conclusions that may serve, together with the IPs themselves, as considerations for future standard setting.

One EPSAS IP addresses the area of disclosures. It was produced in April 2018 and covered the most important disclosure requirements under the existing international financial reporting frameworks with a view to devising a principled approach to optimising the need for disclosures, against the background of the IPSAS conceptual framework or national public sector GAAPs, given that some disclosure requirements are seen as burdensome by the preparers.

The main types of issues linked to the principled approach to disclosures discussed in the EPSAS Issue paper are:

- Cost and complexity of preparation versus benefits;
- Assessment of materiality and relevance;
- Providing clarity to users;
- Ensuring comparability of government financial statements.

Screening of IPSAS 38 ‘Disclosure of interests in other entities’ against criteria set in the draft EPSAS framework

Introduction

The EPSAS criteria listed in the draft EPSAS framework have been used to perform an assessment of IPSAS 38 ‘Disclosure of interests in other entities’, published in 2015 by the IPSASB.

In order to develop recommendations, one should first consider whether IPSAS 38 would meet the qualitative characteristics of the draft EPSAS CF, i.e. whether it would provide relevant, reliable, complete, prudent, neutral, verifiable, economically substantive, understandable, timely and comparable information and would not be contrary to the true and fair view principle.

This report considers the disclosure requirements applicable to qualifying investments for each of the qualitative characteristics of the draft EPSAS CF.

Further, this paper includes a high-level comparison between the requirements of IPSAS 38 and other international accounting and financial reporting frameworks applied by the public sector entities in various jurisdictions, such as IFRS, ESA 2010 and EU Accounting Rules, bearing in mind the objective of alignment, reduction of cost of implementation and compliance cost.

Finally, it assesses whether IPSAS 38 would be conducive to the European public good.

The findings are presented below, and the conclusion is included in the next section of this report.

Conformity with Qualitative Characteristics

Relevance

Financial and non-financial information is relevant if it is capable of making a difference in achieving the objectives of GPFRs. Financial and non-financial information can make a difference when it has confirmatory value, predictive value, or both.

With respect to disclosures, materiality and relevance of the information should be considered because information is provided to enable a proper understanding of the government's assets, liabilities, income, expenses, cash flows and risks. A specific disclosure requirement in a standard need not be satisfied if the information is not material. However additional disclosures should be given to allow for a proper understanding of a public sector entity's assets and liabilities, performance and cash flows even if the information is not explicitly required by a standard.

The objective of IPSAS 38 is to prescribe the disclosures to be fulfilled in relation to qualifying investments, specifically for interests in controlled entities, unconsolidated controlled entities, joint arrangements and associates, and structured entities that are not consolidated. As a result, users of financial statements can discern information about an entity's investments and changes in such investments and evaluate the nature of, and risks associated with, and the effects of those interests on its financial position, financial performance and cash flows.

Although IPSAS 38 requires, compared to IPSAS 6, IPSAS 7 and IPSAS 8, more extensive and voluminous disclosures about interests in other entities, it requires entities to aggregate or disaggregate the disclosures such that useful information is not obscured. Furthermore, IPSAS 38 puts an emphasis on the disclosure of material and significant items. To meet this requirement, it is assumed that entities will be able to aggregate information reasonably, though, in some cases entities might face difficulties to aggregate data in a consistent and understandable manner, in particular when they hold numerous interests in other entities that are not homogeneous. Judgment will be required in making this aggregation.

<u>Unconsolidated structured entities</u>

IPSAS 38 requires an entity to disclose qualitative and quantitative information about the nature of its interest in unconsolidated structured entities which exposes an entity to risks.

According to IPSAS 38, a structured entity is, in the case of entities

- where administrative arrangements or legislation, or
- where voting or similar rights,

are normally the dominant factors in deciding who has control of an entity, an entity that has been designed so that

- administrative arrangements or legislation, or

- voting or similar rights

are not the dominant factors in deciding who controls the entity such as

- when binding arrangements are significant to determining control of the entity or
- when any voting rights relate to administrative tasks only

and relevant activities are directed by means of binding arrangements) (IPSAS 38 para 7).

Although binding arrangements frequently occur between public sector entities, binding arrangements are not normally the dominant factor in determining who controls an entity. Therefore, the use of binding arrangements to determine the relevant activities of an entity may indicate the existence of a structured entity. An entity's involvement in transactions with a structured entity can, due to the special nature and designed purpose of the entity, expose that entity to different types of risks. As a result, a framework for disclosing information on structured entities that are not consolidated is relevant, as it ensures that sufficient information is provided to understand an entity's involvement with those unconsolidated entities, including exposure to guarantees and commitments, potential losses and the impact on the entity's performance. The described disclosure requirement of IPSAS 38 was developed specifically to address users' concerns about information on off-balance sheet entities and should result in a significant increase in transparency and useful information to users.

Administrative arrangements and statutory provisions (legislation) are common means by which control may be determined for many public sector entities. Accordingly, the reference to 'similar rights' in the definition of structured entity should encompass administrative arrangements and statutory provisions (IPSAS 38 BC15). The disclosures required for structured entities are appropriate, but in order to be useful they need to be focused on material information. It is possible that the broad definition of unconsolidated structured entities will encompass many interests that are insignificant to the reporting entity and the disclosures in IPSAS 38 might result in a mix of relevant and irrelevant information. However, IPSAS 38 provides guidance on how an entity should aggregate the data and it clarifies that materiality is a key point of focus. The focus on 'materiality' is expected to help preparers to develop a consistent and understandable pattern of aggregation policies for items that have similar characteristics.

In line with IPSAS 38 an entity should disclose qualitative and quantitative information about its interests in structured entities that are not consolidated, including, but not limited to, the nature, purpose, size and activities of the structured entity and how the structured entity is financed (IPSAS 38 para 43). An entity is required to provide disclosures when it has no interests in a structured entity at the end of reporting period but may still be required to support the structured entity. This information is useful to users because, as a sponsor of that structured entity, the entity can remain exposed to risks including reputational or litigation risk and commitments for ongoing support.

Significant judgements and assumptions

An entity should disclose the methodology used to determine that it has control or joint control of an arrangement or significant influence over another entity and the type of joint arrangement (i.e. joint operation or joint venture) when the arrangement has been structured through a separate vehicle (IPSAS 38 para 12). Although users need information about how an entity has made these judgments, a public sector entity could be required to make many judgments and assumptions in relation to particular entities, and the disclosure of such judgments and assumptions and changes in such judgments from period to period could result in unnecessary detail. Also, in the public sector, decisions about the reporting entity may be made having regard to frameworks developed in conjunction with other parties such as legislative bodies or oversight committees. The assessments made in respect of the classification of certain types of entities as controlled entities, jointly controlled entities, or entities subject to significant influence may be recorded in public documents other than the financial statements. Therefore, an entity can disclose the methodology used to decide the existence or absence of control, joint control of an arrangement or significant influence, either in the financial statements themselves or by way of reference to another publicly available document (IPSAS 38 para BC3).

The assessment of whether an entity controls, jointly controls or significantly influences another entity requires a degree of judgement that would generally depend on factors such as complexity of the transaction and ownership structure of the underlying investee. The disclosure requirements in IPSAS 38 aim at shedding light on how an entity determines the nature of its interest in another entity or joint arrangement that supports an entity's assessment, and hence is relevant to users.

IPSAS 35 introduces a uniform consolidation principle and removes the classification by predefined rules. The level of judgement is significant when an entity holds less than the majority of voting rights, or the ownership structure of the investee is complex and involves investors that are widely dispersed. IPSAS 38 also requires disclosures about significant judgements and assumptions in determining whether a joint arrangement under IPSAS 37 is a joint operation or a joint venture. This assessment requires management to consider all facts and circumstances to determine the classification of a joint arrangement, particularly when it is structured through a separate entity. In these cases, the information about the level of judgement and assumptions made to determine control over an investee, and on factors that support the classification decision, is relevant for users to understand the consolidation decisions taken by entities.

Interests in controlled entities (subsidiaries with material non-controlling interests)

An entity should disclose information that enables users of its consolidated financial statements:

- to understand the composition of the economic entity and the interest that non-controlling interests have in the economic entity's activities and cash flows; and

- to evaluate the nature and extent of significant restrictions on its ability to access or use assets, and settle liabilities, of the economic entity, the nature of, and changes in, the risks associated with its interests in consolidated structured entities, the consequences of changes in its ownership interest in a controlled entity that do not result in a loss of control and the consequences of losing control of a controlled entity during the reporting period (IPSAS 38 para 17).

IPSAS 38 requires disclosures in relation to subsidiaries that have non-controlling interests (NCI) that are material to the reporting entity. This requirement aims to address users' concerns about the lack of information about NCI in relation to cash flows attributable to the owners of the parent entity and those attributable to the NCI. The information enables users to understand the composition of a group and how surplus or deficit is distributed amongst owners. Furthermore, the information helps users to identify the subsidiaries that hold debt, to assess the financial situation of a particular entity structure within the group and the ability to generate cash and to fund its commitments. For the reasons explained above, the expanded disclosures seem relevant to users and help address concerns about the lack of useful information in this area.

<u>Consolidated structured entities</u>

IPSAS 38 requires additional disclosures about consolidated structured entities that are not required for other non-structured subsidiaries. In particular, IPSAS 38 requires an entity to disclose the terms of any binding arrangements that could require the controlling entity or its controlled entities to provide financial support to a consolidated structured entity, including events or circumstances that could expose the reporting entity to a loss (e.g. liquidity arrangements or credit rating triggers associated with obligations to purchase assets of the structured entity or provide financial support) (IPSAS 38 para 21). If during the reporting period a controlling entity or any of its controlled entities has, without having an obligation under a binding arrangement to do so, provided financial or other support to a consolidated structured entity (e.g. purchasing assets of, or instruments issued by, the structured entity), the entity should make additional disclosures on the type and amount of support provided, and the reasons for providing the support (IPSAS 38 para 22). Similarly, without having an obligation under a binding arrangement, if financial or other support is provided to a previously unconsolidated structured entity and that provision of support resulted in the entity controlling the structured entity, the entity should disclose an explanation of the relevant factors in reaching that decision (IPSAS 38 para 23). This disclosure should be relevant for users in order to assess the risks associated with the interest in that entity, and the level of support provided by an entity to structured entities. Also, this requirement refers to the provision of support by a parent or a subsidiary of the group to the consolidated structured entity which transactions are eliminated in the consolidated financial statements, and therefore not reflected without additional disclosures.

Interests in unconsolidated controlled entities (investment entities)

When a controlling entity determines that it is an investment entity in accordance with IPSAS 35, the investment entity should disclose information about significant judgments and assumptions it has made in determining that it is an investment entity (IPSAS 38 para 15). When an entity becomes, or ceases to be, an investment entity, it should disclose the change of investment entity status and the reasons for the change. In addition, an entity that becomes an investment entity should disclose the effect of the change of status on the financial statements for the period presented (IPSAS 38 para 16). An investment entity that, in accordance with IPSAS 35, is required to apply the exception to consolidation and instead account for its investment in a controlled entity at fair value through surplus or deficit, should disclose that fact (IPSAS 38 para 27). Similarly, to consolidated structured entities, IPSAS 38 requires additional disclosures in terms of financial and other support provided as a result of obligations arising from binding arrangements or obligations not stated in binding arrangements (IPSAS 38 para 32-33). These disclosure requirements enhance the relevance and completeness of information included in the financial statements as investment entities are not consolidated, and therefore limited information about them is disclosed in the financial statements.

Interests in joint arrangements and associates

IPSAS 38 requires additional disclosures about an entity's interests in joint arrangements (particularly joint ventures) and associates about the nature, extent and financial effects of its interests, including the nature and effects of its relationship with the other investors with joint control of, or significant influence over, joint arrangements and associates and the nature of, and changes in, the risks associated with its interests in joint ventures and associates (IPSAS 38 para 35).

The requirement mainly focuses on joint ventures and associates that are material to the reporting entity and require less detailed information for individually immaterial investments. It aims to address concerns expressed by users about a lack of information regarding the nature and extent of risks associated with associates and joint ventures as well as the potential loss of information due to the elimination of proportionate consolidation for joint arrangements classified as joint ventures under IPSAS 37. In practice, users may require more comprehensive breakdown of current assets and current and non-current liabilities (in particular, cash and certain financial liabilities) to help them understand the asset and debt position of joint ventures. In addition to that there is a need for more comprehensive information about amounts that would help them when valuing an entity's investment in a joint venture that is accounted for under the equity method. The summarised financial information should be based on IPSASs and reconciled to the carrying amount of the investment in the reporting entity's financial statements. In general, the summarised financial information required for each joint venture and associate that is material to the reporting entity addresses some of these needs, as it enhances the relevance of information provided to users. The reconciliation of summarised information to the carrying amount of the investment also provides users with a relevant reference point. The aggregation of information provided for individually immaterial associates and joint ventures that are accounted for under the equity method will alleviate concerns about excessive and too granular information.

An entity should disclose commitments that it has relating to its joint ventures separately from the amount of other commitments and in accordance with IPSAS 19 ‘Provisions, contingent liabilities and contingent assets’, unless the probability of loss is remote, contingent liabilities incurred relating to its interests in joint ventures or associates (including its share of contingent liabilities incurred jointly with other investors with joint control of, or significant influence over, the joint ventures or associates), separately from the amount of other contingent liabilities (IPSAS 38 para 39). This type of disclosure contains forward-looking information and has a predictive value, so it results in the provision of relevant information.

IPSAS 38 requires only limited disclosure in relation to interests in joint arrangements classified as joint operations, because in those cases the joint operator recognises assets, liabilities, revenue and expense that arise from its interest in the joint operation in accordance with all applicable IPSASs. It is therefore not necessary to require further information in IPSAS 38 in relation to joint operations. For the reasons explained above, an overall assessment of IPSAS 38 is that it results in the provision of relevant information, and satisfies the relevance criterion.

Faithful representation / Reliability

To be reliable, financial and non-financial information must provide a faithful representation of the substance of economic and other phenomena that it purports to represent. The notion of faithful representation and reliability in the draft EPSAS CF is linked to the qualitative characteristics of completeness, prudence, neutrality, verifiability, substance over form and being free from material error. These characteristics are separately discussed below.

Unconsolidated structured entities

An entity with an interest in a structured entity often has the information (or some of the information) required in IPSAS 38, if it is used for its internal risk management purposes or for compliance with regulatory reporting. However, some entities may not have all the information readily available to comply with all the requirements in IPSAS 38 regarding unconsolidated structured entities, particularly when they are managed by other parties unrelated to the entity. In these cases, new processes or contractual agreements might need to be established to ensure the entity has access to the required information on a timely basis. Once entities have the processes in place, the initial concerns about reliability should diminish.

Amongst others, an entity should disclose in tabular format, unless another format is more appropriate, a summary of the amount that best represents the entity’s maximum exposure to loss from its interests in structured entities that are not consolidated, including how the maximum exposure to loss is determined. If an entity cannot quantify its maximum exposure to loss from its interests in structured entities that are not consolidated it should disclose that fact and the reasons (IPSAS 38 para 46 (c)). If the information to be disclosed may not be determined reliably, then it should be noted and explained in the notes of the financial statement. The disclosure requirement about the 'current intention' to provide financial support to an unconsolidated structured entity is forward-looking information whose reliability may be difficult to verify. However, this type of information is already required by other IPSASs. For example, IPSAS 19 'Provisions, contingent liabilities and contingent assets' necessitate disclosure of information about uncertain future events (such as contingent liabilities), hence the requirements in IPSAS 38 should not considered to be so exceptional that they would raise additional concerns about reliability.

<u>Significant judgements and assumptions</u>

Information about significant judgements and assumptions made in assessing control and significant influence, are already required under existing IPSASs, including IPSAS 1 'Presentation of financial statements'. As a result, this requirement does not impose significant additional concerns with reliability.

<u>Interests in controlled entities (subsidiaries with material non-controlling interests)</u>

Entities should have all or most of the information available in respect of subsidiaries with material NCI in preparing its consolidated financial statements, hence this requirement should provide reliable information in an achievable manner.

<u>Consolidated structured entities</u>

IPSAS 38 requires disclosures that did not exist previously. Entities that are providing financial support to consolidated structured entities, with or without having an obligation to do so, are required to disclose information in this respect. Similar type of forward-looking disclosure is already required in other IPSASs, for example IPSAS 19 requires an entity to provide information on contingent liabilities and provide estimates of its financial effects. Therefore, the disclosure requirements regarding the nature of risks associated with an entity's interests in consolidated structured entities should not cause significant issues with reliability of information.

<u>Interests in joint arrangements and associates</u>

IPSAS 38 requires an entity to provide qualitative information and summarised financial information for each joint venture and associate that is material to the reporting entity. The qualitative information (e.g. name, place of business, legal form, activities and proportion of ownership interests) should be readily available and would not lead to significant reliability concerns. For joint ventures and associates accounted for under the equity method, the summarised financial information required by IPSAS 38 should be based on the joint venture's or associate's IPSAS financial statements (and not the entity's share of those amounts). The amounts included in the IPSAS financial statements of the joint venture or associate should be adjusted to reflect adjustments made by the entity when using the equity method, such as fair value adjustments made at the time of acquisition and adjustments for differences in accounting policies. In addition, the standard requires summarised financial information to be reconciled to the carrying amount of its interest in the joint venture or associate in the reporting entity's financial statements. For individually immaterial associates and joint ventures that are accounted for under the equity method, the information requirements are less detailed, and an entity is required to provide aggregate financial information.

In some cases, entities may need to perform additional procedures and perhaps change the reporting structures to gather the required IPSAS data for investments in joint ventures and associates. However, entities should have most of the required information and the requirements should not result in unreliable financial information due to the difficulty of data collection.

Controlling interests acquired with the intention of disposal

An entity, other than an investment entity, should disclose information regarding its interest in a controlled entity when, at the point at which control arose, the entity had the intention of disposing of that interest and, at the reporting date, it has an active intention to dispose of that interest (IPSAS 38 para 51). There are situations in which a public sector entity may obtain control of another entity, but where the entity has an active intention to dispose of all or part of its controlling interest in the near future. This requirement provides a faithful representation of the substance of economic and other phenomena that it purports to represent and therefore enhances reliability.

The overall conclusion is that IPSAS 38 satisfies the reliability criterion.

Completeness

The information which fulfils the recognition criteria should be complete within the bounds of materiality and cost-benefit considerations.

IPSAS 38 should be applied by an entity that has an interest in any controlled entities, joint arrangements (i.e. joint operations or joint ventures), associates or structured entities that are not consolidated. IPSAS 38 does not apply to:

(a) Post-employment benefit plans or other long-term employee benefit plans to which IPSAS 39, Employee Benefits applies.

(b) An entity's separate financial statements to which IPSAS 34 'Separate Financial Statements', applies with certain exceptions.

(c) An interest held by an entity that participates in, but does not have joint control of, a joint arrangement unless that interest results in significant influence over the arrangement or is an interest in a structured entity.

(d) An interest in another entity that is accounted for in accordance with IPSAS 41 'Financial Instruments' (IPSAS 38 para 4).

Based on scope exclusions, IPSAS 38 does not raise any significant issues concerning completeness.

Non-quantifiable ownership interests

Some contributions made by public sector entities may be referred to as an ‘investment’ but may not give rise to an ownership interest. Accordingly, the public sector entity is not exposed to the risks, nor does it enjoy the rewards, that are incidental to an ownership interest. As a result, those transactions are not included within the scope of IPSAS 36. The noted requirement is considered to be appropriate, reliable and complete, especially as disclosure of information about an entity’s non-quantifiable ownership interests in other entities is required by IPSAS 38.

Interests in controlled entities, joint arrangements and associates

When the financial statements of a controlled entity, joint venture and associate used in the preparation of consolidated financial statements or applying the equity method are as of a date or for a period that is different from that of the consolidated financial statements an entity shall disclose:

(a) the date of the end of the reporting period of the financial statements of that controlled entity or joint venture and associate; and

(b) the reason for using a different date or period (IPSAS 38 para 18).

The above requirement enhances and is likely to help users to assess the comparability of financial information used for the purpose of consolidation.

Significant judgements and assumptions

The disclosures required should be either given in the financial statements or incorporated by cross-reference from the financial statements to some other statement that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross reference, the financial statements are incomplete. The use of such cross-referencing may be subject to jurisdictional restrictions (IPSAS 38 para 13). Cross-referencing enhances the QC of completeness.

Interests in unconsolidated controlled entities (investment entities)

If an investment entity is the controlling entity of another investment entity, the controlling entity should also provide the disclosures for investments that are controlled by its controlled investment entity. The disclosure may be provided by including, in the financial statements of the controlling entity and the controlled entity (or controlled entities) that contain information on the controlled entity’s name, domicile, legal form and jurisdiction in which it operates, and the proportion of ownership interest held by the investment entity and, if different, the proportion of voting rights held (IPSAS 38 para 29). This requirement enhances completeness;

however it could impose additional complexity in terms of collecting and presenting supplementary information for financial statement preparation purposes.

Interests in joint arrangements and associates

An entity should also disclose the unrecognised share of losses of a joint venture or associate, both for the reporting period and cumulatively, if the entity has stopped recognising its share of losses of the joint venture or associate when applying the equity method (IPSAS 38 para 38 (c)). Also, an entity shall disclose total commitments it has made but not recognised at the reporting date (including its share of commitments made jointly with other investors with joint control of a joint venture) relating to its interests in joint ventures (IPSAS 38 para 39 (b)). Commitments are those that may give rise to a future outflow of cash or other resources that results in a faithful and complete representation of financial information.

The screening analysis of IPSAS 38 has not identified any significant issue that could be linked to the QC ‘Completeness’.

Prudence

Prudence is the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets or revenue are not overstated while liabilities or expenses are not understated.

Significant judgements and assumptions

IPSAS 1 ‘Presentation of financial statements’ already requires disclosure about significant judgements and assumptions made in applying the entity’s accounting policies that have a significant effect on the amounts recognised in the financial statements. The main objective of IPSAS 38 disclosure requirements is to develop a principle that requires an entity to disclose information about all significant judgements and assumptions made in determining the nature of its interest in another entity.

Aggregation

An entity should decide, in the light of its circumstances, how much detail it provides to satisfy the information needs of users, how much emphasis it places on different aspects of the requirements and how it aggregates the information. It is necessary to strike a balance between burdening financial statements with excessive detail that may not assist users of financial statements and obscuring information as a result of too much aggregation (IPSAS 38 para AG2). An entity may aggregate the disclosures required by IPSAS 38 for interests in similar entities if aggregation is consistent with the disclosure objective and the requirement and does not obscure the information provided. An entity should disclose how it has aggregated its interests in similar entities (IPSAS 38 para AG3). In determining whether to aggregate information, an entity should consider quantitative and qualitative information about the different risk and benefit characteristics of each entity it is considering for aggregation and the significance of each such entity to the reporting entity. The entity should present the disclosures in a manner that clearly explains to users of financial statements the nature and extent of its interests in those other entities (IPSAS 38 para AG4). In deciding on the appropriate level of aggregation to be applied under the requirements of IPSAS 38 may include judgement and the risk is that the level of aggregation is not properly defined which could affect the faithful representation of financial information.

The screening analysis of IPSAS 38 has not identified any issue that could be linked to the QC ‘Prudence’.

Neutrality

Information is neutral if it is free from bias. GPFSs are not neutral if the information they contain has been selected or presented in a manner designed to influence the making of a decision or judgment in order to achieve a predetermined result or outcome.

The principles included in IPSAS 38 have been tested for many years in the private sector. Users perceived no negative impact of IFRS 12 on the neutrality of the IFRS financial statements. In some cases, the guidance and examples provided in IPSAS 38 might be interpreted in different ways which may lead to inconsistency and diverse application within the group entities. In particular, when determining the appropriate level of aggregation that may lead to differences in the purported information.

On the other hand, in a principles-based control model, the use of judgement is an inherent factor, and the disadvantage of applying principles instead of rules, is that there might be divergence in practice. As noted earlier in the discussion about the QCs of relevance and reliability, the level of judgment required by IPSAS 38 is not so exceptional in nature that it would be impracticable to apply the standard in a consistent manner and achieve a neutral presentation of the reporting entity.

Verifiability

Verifiability is the quality of information that helps assure users that GPFSs is based on supporting evidence in a way that it faithfully represents the substance of economic and other phenomena that it purports to represent.

In conclusion, the provisions of IPSAS 38 faithfully represent the substance of economic and other phenomena of the underlying transactions. Also, a cohesiveness between various disclosure notes required by IPSAS 38 provides evidence of verifiable and reliable information.

Interest in another entity

An interest in another entity, refers to involvement by way of binding arrangements or otherwise that exposes an entity to variability of benefits from the performance of the other entity. An interest in another entity can be evidenced by, but is not limited to, the holding of equity or debt instruments as well as other forms of involvement such as the provision of funding, liquidity support, credit enhancement and guarantees. It includes the means by which an entity has control or joint control of, or significant influence over, another entity. An entity does not necessarily have an interest in another entity solely because of a typical funder/recipient or customer/supplier relationship (IPSAS 38 para 7). Binding arrangements can be evidenced in several ways. A binding arrangement is often, but not always, in writing, in the form of a contract or documented discussions between the parties. Statutory mechanisms such as legislative or executive authority can also create enforceable arrangements, similar to contractual arrangements, either on their own or in conjunction with contracts between the parties (IPSAS 38 para 8). Overall, the underlying principles in determining the existence of interests in other entities support the 'Verifiability' QC.

Interests in controlled entities

An entity should present a schedule that shows the effects on the net assets/equity attributable to owners of the controlling entity of any changes in its ownership interest in a controlled entity that do not result in a loss of control. These provisions enhance the verifiability of IPSAS 38 requirements.

Interests in joint arrangements and associates

For each joint venture and associate that is material to the reporting entity:

(i) whether the investment in the joint venture or associate is measured using the equity method or at fair value;

(ii) summarised financial information about the joint venture or associate; and

(iii) if the joint venture or associate is accounted for using the equity method, the fair value of its investment in the joint venture or associate, if there is a quoted market price for the investment (IPSAS 38 para 36 (b)).

The objective of the disclosure it to make the fair value information verifiable against other sources of observable evidence available to the market participants.

Substance over form

QC 'Substance over form' is achieved when the underlying transactions, other events, activities or circumstances are accounted for and presented in accordance with their economic reality, and not merely their legal form which is the case in as a result of the IPSAS 38's requirements.

Interests in other entities

Consideration of the purpose and design of the other entity may help the reporting entity when assessing whether it has an interest in that entity and, therefore, whether it is required to provide the disclosures in IPSAS 38 (IPSAS 38 para AG7). That assessment should include consideration of the risks that the other entity was designed to create and the risks the other entity was designed to pass on to the reporting entity and other parties. The focus in the purpose and design of an entity enhances QC 'Substance over form'.

Significant judgements and assumptions

An entity should disclose, for example, the factors considered in determining that:

(a) it controls a specific entity (or similar category of entities) where the interest in the other entity is not evidenced by the holding of equity or debt instruments;

(b) it does not control another entity (or category of entities) even though it holds more than half of the voting rights of the other entity (or entities);

(c) it controls another entity (or category of entities) even though it holds less than half of the voting rights of the other entity (or entities);

(d) it is an agent or a principal;

(e) it does not have significant influence even though it holds 20 per cent or more of the voting rights of another entity; and

(f) it has significant influence even though it holds less than 20 per cent of the voting rights of another entity (IPSAS 38 para 14).

This requirement supports the QC 'Substance over form' by taking into account all factors in making assessments on the existence of control and significant influence.

Understandability

'Understandability' QC is met when information is presented in a manner that facilitates expert and non-expert users to comprehend its meaning. Although there are a number of aspects to the notion of 'understandability', most of the aspects are covered by the discussion above about relevance, reliability and comparability.

Aggregation

As mentioned under QC 'Comparability', one of the objectives of IPSAS 38 is to integrate in one standard all disclosure requirements for interests a reporting entity has in other entities, including unconsolidated structured entities. IPSAS 38 sets out a clear objective for all disclosures required, which is to enable users to evaluate the nature of and risks associated with its interests in other entities, and to assess the effects of those interests on the financial position, financial performance and cash flows. IPSAS 38 requires an entity to consider the level of detail necessary to satisfy the disclosure objective and to aggregate or disaggregate disclosures, so that useful information is not obscured by either inclusion of voluminous insignificant detail or the aggregation of items that have different characteristics. IPSAS 38 provides examples of aggregation criteria and requires the entity to disclose how it has aggregated the information.

IPSAS 38 requires more comprehensive disclosures in some areas (e.g. interests in unconsolidated structured entities, summarised financial information about interests in subsidiaries with material NCI, material joint ventures and material associates). If the new voluminous disclosures are not aggregated in a reasonable manner, and provided in a meaningful way, this could impact understandability of financial reporting. Challenges may arise when an entity has numerous investments that are not homogeneous.

Controlling interests acquired with the intention of disposal

Because of a government's broad responsibility for the economic well-being of a jurisdiction it may intervene to prevent the consequences of failure of an entity, such as a financial institution. Such interventions may lead to a government obtaining control of another entity, although it has no intention of maintaining control over that entity. Rather, its intention may be to sell, or otherwise dispose of, its interest in the controlled entity. If the other entity needs to be restructured to facilitate disposal, the restructuring can occur over a period of one or more years and the government may retain some residual assets or liabilities at the end of the process. The consolidation of such controlled entities for the reporting periods in which control is present, can have a significant impact on the consolidated financial statements. The obtaining of control as a result of interventions to prevent failure is most likely to occur in the context of governments but could also occur in the case of individual public sector entities (IPSAS 38 para 53). A public sector entity may also acquire a controlling interest in another entity, with the intention of disposing of all or part of that interest, in implementing a government's policy objectives (IPSAS 38 para 54). In accordance with this fact, the disclosure requirements of IPSAS 38 improve the understandability of information to the users of the financial statements and well describe the nature and underlying purpose of a transaction.

The principles of IPSAS 38 do not raise any significant concerns and introduce any complexities that may impair understandability.

Comparability

Comparability is the quality of information that enables users to identify similarities in, and differences between, two sets of phenomena in different reporting entities or in one reporting entity at different points in time. A key objective of EPSAS is to achieve the necessary level of financial transparency and comparability of financial reporting, between and within EU Member States.

Comparability may be enhanced if a standardised format of disclosures, which supports a standardised presentation of the information included in the financial statements, be developed. Setting up the right balance between a standardised format of disclosures and allowing for departure from this standard format to allow more tailored and relevant information to be provided may prove to be difficult. In IPSAS 38 there are examples of standardised format related to interests in structured entities that are not consolidated. Specifically, an entity should disclose in tabular format revenue from those structured entities during the reporting period, including a description of the types of revenue presented or the carrying amount (at the time of transfer) of all assets transferred to those structured entities during the reporting period, unless another format is more appropriate, and classify its sponsoring activities into relevant categories (IPSAS 38 para 44-45).

Similarly, developing clear disclosure objectives may also contribute to achieving better comparability. The absence of disclosure objectives, coupled with lists of prescriptively written disclosure requirements, encourages entities to apply those disclosure requirements mechanically as a checklist for the preparation of the financial statements rather than focusing on what information to communicate to users of the financial statements. The comparability of information provided by the disclosure requirement under IPSAS 38 is determined more by the provision of a general objective and aggregation guidance rather than specific disclosure requirements. The application guidance in IPSAS 38 should help with consistent interpretation and application of the disclosure requirements. The standard prescribes a list of mandatory disclosures in some areas and provides examples of additional disclosures.

Some terms remain undefined in IPSAS 38 (for example, ‘sponsor’, ‘financial support’, ‘size of a structured entity’) which could result in inconsistent interpretations of the underlying terms and affect comparability of information. However, the objectives of IPSAS 38 are clearly laid out in the standard, therefore entities should be able to develop definitions that are consistent with IPSAS 38’s objectives and mitigate potential loss of comparability within and between entities in the initial year(s) of implementation, while getting familiar with the requirements.

In conclusion, the disclosures about interests in unconsolidated structured entities should improve the comparability of information between entities, as previously the lack of guidance has led to divergence in practice and inconsistencies in the information provided in the notes to the financial statements in relation to risks associated with those entities.

Finally, the use of judgment and estimates may to some extent impair the comparability of financial statements.

Overall, the guidance in IPSAS 38 should help with consistent interpretation and application of the accounting requirements. To sum up, the provisions of IPSAS 38 have been developed as a package, which should promote consistency and coherence of the requirements thereby comparability of financial reporting.

Alignment with other frameworks

ESA 2010

Alignment with ESA reporting is desirable, to avoid the burden of a dual reporting in the public sector. Differences with ESA 2010 reporting requirements should be avoided where possible, both regarding the scope of entities to be included in the IPSAS scope of reporting and the IPSAS requirements in terms of measurement and disclosures.

However, since ESA 2010 is a macro level reporting framework, it does not require entity-level reporting on disclosures related to interests in other entities.

IFRS[3]

IPSAS 38 'Disclosure of interests in other entities' is drawn primarily from IFRS 12 'Disclosure of interests in other entities' (issued in 2011, including amendments up to December 31, 2014). The main differences between IPSAS 38 and IFRS 12 are as follows:

- IPSAS 38 uses different terminology, in certain instances, from IFRS 12.
- The definition of a structured entity in IPSAS 38 acknowledges the differing ways in which control may be obtained in the public sector.
- IPSAS 38 requires that a controlling entity that controls an investment entity, and is not itself an investment entity, disclose information in respect of unconsolidated investment entities. IFRS 12 does not require such disclosures by a controlling entity that controls an investment entity and is not itself an investment entity because IFRS 10 requires that such a controlling entity consolidate controlled investment entities.
- IPSAS 38 requires the disclosure of information about non-quantifiable ownership interests. IFRS 12 does not specify such disclosures.
- IPSAS 38 requires the disclosure of information about interests in entities that were acquired with the intention of disposal and which are still held for disposal. IFRS 12 does not specify such disclosures. However, IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations' requires disclosures about non-current assets held for sale.

[3] Refer to the IPSAS-IFRS Alignment Dashboard regularly updated by the IPSASB available on https://www.ifac.org/system/files/uploads/IPSASB/Agenda%20Item%201.5%20IPSAS%20IFRS%20Alignment%20Dashboard_June%202019.pdf

EU accounting rules

The objective of EU Accounting Rule 2 ’Consolidation and accounting for joint arrangements and associates’ is to define the economic entity in the European Union (EU) context, controlled entities, jointly controlled entities and associates, to identify the circumstances in which they should be consolidated and how they should be included in the consolidated accounts. This accounting rule also requires certain information to be disclosed about interests in controlled entities, joint arrangements, associates and structured entities in the notes to the financial statements.

This accounting rule is based on the following IPSAS standards:

- IPSAS 35 'Consolidated financial statements'
- IPSAS 36 'Investments in associates and joint ventures'
- IPSAS 37 'Joint arrangements', and
- IPSAS 38 'Disclosure of interests in other entities'

The principles included in EU AR 2 are similar to IPSAS.

An EU entity should consider the level of detail necessary to satisfy the disclosure objective. It should aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or aggregation of items that have different characteristics.

In accordance with EU AR 2, disclosure of information is required about:

- controlled entities, as significant judgements and assumptions, listing of consolidated entities, nature and extent of significant restrictions and nature of risk associated with interest in consolidated structured entities, consolidation procedures and changes in a controlling entity's ownership interest in a controlled entity;
- joint arrangements and associates, as significant judgements and assumptions, listing of significant associates and joint arrangements, summarised financial information for associates and joint ventures, application of equity method to interests in associates and joint ventures, significant restrictions on funds transfers, risks associated with interests in associates and joint ventures;
- interests in unconsolidated controlled entities (investment entities);
- interests in structured entities that are not consolidated, as nature of interests and nature of risks;
- non-quantifiable ownership interests;
- controlling interests acquired with the intention of disposal.

European Public Good

Assessing whether IPSAS 38 is conducive to the European public good

The assessment of whether IPSAS 38 would be conducive to the European public good addresses the following items:

a) Whether the standard will improve financial reporting;
b) The costs and benefits associated with the standard; and
c) Whether the standard could have an adverse effect to the European economy, including financial stability and economic growth.

These assessments will allow the EU authorities to draw a conclusion as to whether the standard is likely to be conducive to the European public good.

The analysis revealed no reasons why IPSAS 38 would not be conducive to the European public good:

- The disclosure requirements of IPSAS 38 will provide useful information to the users of the GPFSs and will improve the overall quality of financial reporting in the public sector. Implementation of the standard should result in a moderate one-off cost and should be relatively cost-neutral on an ongoing basis for preparers, however these practical challenges do not overweight the conceptual merits of the standard.

- Considering its conceptual merits, the standard will bring improved financial reporting when compared to heterogeneous reporting requirements currently applied in the EU. As such, its endorsement is conducive to the European public good in that improved financial reporting improves transparency and assists in the assessment of management stewardship. The analysis has not identified any adverse effect of the standard to the European economy, including financial stability and economic growth, or any other factors that would mean the standard is not conducive to the European public good.

Conclusion

Assessing IPSAS 38 against the criteria formulated in the draft EPSAS framework

The analysis has not revealed major conceptual issues with IPSAS 38 ‘Disclosure of interests in other entities’ and has not identified any inconsistency between IPSAS 38 and the draft EPSAS framework.

Following the screening analysis summarised in the present report, the future standard setter could consider the following conclusions. The information resulting from the application of IPSAS 38:

- would provide relevant, reliable, complete, prudent, neutral, verifiable, economically substantive, understandable, timely and comparable information needed for making economic decisions and achieving the necessary level of financial transparency and comparability of financial reporting in the European Union;
- would not be contrary to the true and fair view principle; and
- would be conducive to European public good.

However, in order to achieve consistent application of the new standard within the EU context and therefore better address the comparability objective of EPSAS financial statements, additional guidance and improvements in certain areas might be desirable.

- *Judgment and comparability.* The use of judgment and estimates is inherent in the preparation of financial statements and may to some extent affect the comparability of financial statements. In the case of this particular standard, this may relate to the determination of the appropriate level of aggregation to be applied for providing the disclosures required by IPSAS 38, taking also into account the need to reduce disclosures to the necessary minimum.

The analysis has not identified any adverse effect of the standard to the European economy, including financial stability and economic growth, or any other factors that would mean the standard is not conducive to the European public good.

The future standard setter could consider the conclusions of this assessment and likely net benefit of using the requirements of IPSAS 38 as a starting point for developing an equivalent EPSAS, considering the need for additional guidance in certain areas and resolution of the matters identified in the present EPSAS screening report.