This accounting policy paper is based on IPSAS 35 Consolidated Financial Statements, as adopted by the Treasury of the Republic of Cyprus.

# Consolidated Financial Statements

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# 1. INTRODUCTION

## 1.1 OVERVIEW

Consolidated financial statements are presented when an entity controls one or more other entities.

A controlling entity's consolidated financial statements are based on the principle of control. Different accounting treatment is followed for the following two circumstances:

Controlling entity accounts for controlled entities by applying consolidation procedures.

(Applies in most cases)

Controlling investment entity accounts for controlled entities by applying Fair Value measurement.

## 1.2 OBJECTIVES

The objective of this accounting policy is to establish the principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.

The aim of this policy is to provide technical accounting guidance for the preparation of financial statements, to ensure that these will give a true and fair view. The aforementioned policy is prepared following guidance from all relevant International Public Sector Accounting Standards (IPSASs).

## 1.3 SCOPE

An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this policy in the preparation and presentation of consolidated financial statements for the economic entity.

## 1.4 DEFINITIONS

**Associate** is an entity over which the investor has significant influence.

**Benefits** are the advantages an entity obtains from its involvement with other entities. Benefits may be financial or non-financial. The actual impact of an entity's involvement with another entity can have positive or negative aspects.

**Binding arrangement** is an arrangement that confers enforceable rights and obligations on the parties to it as if it were in the form of a contract. It includes rights from contracts or other legal rights. 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.

**Consolidated financial statements** are the financial statements of an economic entity in which the assets, liabilities, net assets/equity, revenue, expenses and cash flows of the controlling entity and its controlled entities are presented as those of a single economic entity.

**Control** - An entity controls another entity when the entity is exposed, or has rights, to variable benefits from its involvement with the other entity and has the ability to affect the nature or amount of those benefits through its power over the other entity.

**Controlled entity** is an entity that is controlled by another entity.

**Controlling entity** is an entity that controls one or more entities.

**Decision-maker** is an entity with decision-making rights that is either a principal or an agent for other parties.

**Economic entity** is a controlling entity and its controlled entities. Other terms sometimes used to refer to an economic entity include administrative entity, financial entity, consolidated entity, and group.

**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.

**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) Has the purpose of investing funds solely for returns from capital appreciation, investment revenue, or both; and
c) Measures and evaluates the performance of substantially all of its investments on a fair value basis.

**Joint venture** is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

**Non-controlling interest** is the net assets/equity in a controlled entity not attributable, directly or indirectly, to a controlling entity.

**Power** consists of existing rights that give the current ability to direct the relevant activities of another entity.

**Protective rights** are rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate.

**Relevant activities** are activities of the potentially controlled entity that significantly affect the nature or amount of the benefits that an entity receives from its involvement with that other entity.

**Removal rights** are rights to deprive the decision-maker of its decision-making authority.

**Significant influence** is the power to participate in the financial and operating policy decisions of another entity but is not control or joint control of those policies.

Any other terms defined in other accounting policies that have been adopted by the government of the Republic of Cyprus, have the meaning presented in those accounting policies.

# 2. CONTROL

> "An entity controls another entity ***if and only if*** the entity has ***all*** the following:
>
> a) Power over the other entity;
>
> b) Exposure, or rights, to variable benefits from its involvement with the other entity; and
>
> c) 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." *(IPSAS 35)*

An entity shall determine whether it is a controlling entity by assessing whether it controls another entity, regardless of the nature of its involvement with the other entity. The entity shall consider all facts and circumstances when assessing whether it controls another entity, and shall reassess whether it controls another entity if facts and circumstances indicate that there are changes to one or more of the three elements listed above.

In determining whether an entity controls another entity, the following factors should be considered:

a) The purpose and design of the other entity;
b) What the relevant activities are and how decisions about those activities are made;
c) Whether the rights of the entity give it the current ability to direct the relevant activities of the other entity;
d) Whether the entity is exposed, or has rights to, variable benefits from its involvement with the other entity; and
e) Whether the entity has 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.

## 2.1 POWER

### 2.1.1 GENERAL

An entity has power over another entity when the entity has existing rights that give it the current ability to direct the activities that significantly affect the nature or amount of the benefits from its involvement with the other entity. The right to direct the financial and operating policies of another entity indicates that an entity has the ability to direct the relevant activities of another entity, thus demonstrating power over that entity.

Power arises from rights. In some cases, assessing power is straightforward, such as when power over another entity is obtained directly and solely from voting rights granted by equity instruments such as shares. However, public sector entities often obtain power over another entity from rights other than voting rights, such as rights conferred by binding arrangements which give an entity power to require the other entity to deploy assets or incur liabilities in a way that affects the nature or amount of benefits received by the entity. Assessing whether such rights give rise to power over another entity may be complex and requires more than one factor to be considered.

An entity can have power over another entity even if it does not have responsibility for the day-to-day operation of the other entity or the manner in which prescribed functions are performed by that other entity. Legislation may give statutory bodies or statutory officers powers to carry out their functions independently of government.

Legislation may also set out the broad parameters within which the statutory body is required to operate, and result in the statutory body operating in a manner consistent with the objectives set by Parliament or a similar body. An entity would normally have power over an entity that it has established when the constituting document or enabling legislation specifies the operating and financing activities that are to be carried out by that entity. However, the impact of the constituting document or legislation is evaluated in the light of other prevailing circumstances, as all facts and circumstances need to be considered in assessing whether an entity has power over another entity. Additionally, an entity with the current ability to direct the relevant activities has power even if its rights to direct have yet to be exercised. In the case of an entity established with predetermined activities, the right to direct the relevant activities may have been exercised at the time that the entity was established.

#### 2.1.2 REGULATORY CONTROL

Regulatory control does not usually give rise to power over an entity for the purposes of this accounting policy. The government and other public sector bodies may have powers to establish the regulatory framework within which entities operate, to impose conditions or sanctions on their operations and to enforce those conditions or sanctions. However, when regulation is so tight as to effectively dictate how the entity performs its business, then it may be necessary to consider whether the purpose and design of the entity is such that it is controlled by the regulating entity. Examples are included in paragraphs 1(a) – 1(d) of Appendix 2.

### 2.1.3 RELEVANT ACTIVITIES AND DIRECTION OF RELEVANT ACTIVITIES

For many entities, a range of operating and financing activities significantly affect the benefits they generate. Any activity that assists in achieving or furthering the objectives of a controlled entity may affect the benefits to the controlling entity. Examples of activities that, depending on the circumstances, can be relevant activities include, but are not limited to:

a) Using assets and incurring liabilities to provide services to service recipients;
b) Distributing funds to specified individuals or groups;
c) Collecting revenue through non-exchange transactions;
d) Selling and purchasing of goods or services;
e) Managing physical assets;
f) Managing financial assets during their life (including upon default);
g) Selecting, acquiring or disposing of assets;
h) Managing a portfolio of liabilities;
i) Researching and developing new products or processes; and
j) Determining a funding structure or obtaining funding.

Examples of decisions about relevant activities include, but are not limited to:

a) Establishing operating and capital decisions of an entity, including budgets; and
b) Appointing and remunerating an entity's key management personnel or service providers and terminating their services or employment.

Relevant example is included in paragraph 2 of Appendix 2.

### 2.1.4 RIGHTS THAT GIVE AN ENTITY POWER OVER ANOTHER ENTITY

1. To have power over another entity, an entity must have existing rights that give the entity the current ability to direct the relevant activities of the other entity. Examples of rights that, either individually or in combination, can give an entity power include, but are not limited to:

a) Rights to give policy directions to the governing body of another entity that give the holder the ability to direct the relevant activities of the other entity;
b) Rights in the form of voting rights (or potential voting rights) of another entity;
c) Rights to appoint, reassign or remove members of another entity's key management personnel who have the ability to direct the relevant activities;
d) Rights to appoint or remove another entity that directs the relevant activities;
e) Rights to approve or veto operating and capital budgets relating to the relevant activities of another entity;

f) Rights to direct the other entity to enter into, or veto any changes to, transactions for the benefit of the entity;
g) Rights to veto key changes to the other entity, such as the sale of a major asset or of the other entity as a whole; and
h) Other rights (such as decision-making rights specified in a management contract) that give the holder the ability to direct the relevant activities.

2. In considering whether it has power, an entity shall consider the binding arrangements that are in place and the mechanism(s) by which it has obtained power. Ways in which an entity may have obtained power, either individually or in combination with other arrangements, include:

a) Legislative or executive authority;
b) Administrative arrangements;
c) Contractual arrangements;
d) Founding arrangements (e.g. articles of association); and
e) Voting or similar rights.

3. To determine whether an entity has rights sufficient to give it power, the entity shall also consider the following:

a) The purpose and design of the other entity;
b) The power in place when voting or similar rights do not have a significant effect on benefits (see paragraph 2.1.7(11)); and
c) Whether it has the practical ability to direct the relevant activities unilaterally, considering whether the other entity's key management personnel are related parties of the entity (e.g. the chief executive officer of the other entity and the chief executive officer of the entity are the same person), as well as considering whether the majority of the entity's governing body are related parties to the entity.

4. Additional indicators that may suggest that the entity has more than a passive interest in the other entity and, in combination with other rights, may indicate power include the following:

a) The relationship between the entity and the other entity's operations is one of dependence, such as in the following situations:

   i. The entity funds a significant portion of the other entity's operations and the other entity depends on this.

   ii. The entity guarantees a significant portion of the other entity's obligations and the other entity depends on this.

   iii. The entity provides critical services, technology, supplies or raw materials to the other entity, and the other entity depends on this.

iv. The entity controls assets such as licenses or trademarks that are critical to the other entity's operations and the other entity depends on this.

v. The entity provides key management personnel to the other entity (for example, when the entity's personnel have specialised knowledge of the entity's operations) and the other entity depends on this.

b) A significant portion of the other entity's activities either involve or are conducted on behalf of the entity.

c) The entity's exposure, or rights, to benefits from its involvement with the other entity is disproportionately greater than its voting or other similar rights (for example it may be that an entity is entitled, or exposed, to more than half of the benefits of the other entity but holds less than half of the voting rights of the other entity).

5. Examples are included in paragraphs 3(a) – 3(b) of Appendix 2.

### 2.1.5 Substantive Rights

An entity, in assessing whether it has power, considers only substantive rights relating to another entity (held by the entity and others). For a right to be substantive, the holder must have the practical ability to exercise that right. Factors to consider in determining whether rights are substantive include, but are not limited to:

a) Whether there are any barriers (economic or otherwise) that prevent the holder (or holders) from exercising the rights. Examples of such barriers include, but are not limited to:

i. Financial penalties and incentives that would prevent (or deter) the holder from exercising its rights.

ii. An exercise or conversion price that creates a financial barrier that would prevent (or deter) the holder from exercising its rights.

iii. Terms and conditions that make it unlikely that the rights would be exercised, for example, conditions that narrowly limit the timing of their exercise.

iv. The absence of an explicit, reasonable mechanism in the founding documents of another entity or in applicable laws or regulations that would allow the holder to exercise its rights.

v. The inability of the holder of the rights to obtain the information necessary to exercise its rights.

vi. Operational barriers or incentives that would prevent (or deter) the holder from exercising its rights (e.g. the absence of other managers willing or able to provide specialised services or provide the services and take on other interests held by the manager in office at that time).

vii. Legal or regulatory requirements that limit the manner in which rights may be exercised or that prevent the holder from exercising its rights (e.g. where another entity has statutory powers which permit it to operate independently of the government or where a foreign entity is prohibited from exercising its rights).

b) Whether a mechanism (such as an independent board of directors or other governing body) is in place that provides holder(s) with the practical ability to exercise their rights collectively if they choose to do so, where the case is that the exercise of rights requires the agreement of more than one party, or when the rights are held by more than one party. The lack of such a mechanism is an indicator that the rights may not be substantive. Rights exercisable by an independent board of directors or other governing body are more likely to be substantive than if the same rights were exercisable individually by a large number of entities (or other parties).

c) Whether the party or parties that hold the rights would benefit from the exercise of those rights. For example, the holder of potential voting rights in another entity shall consider the exercise or conversion price of the instrument. The terms and conditions of potential voting rights are more likely to be substantive when the instrument is in the money or the entity would benefit for other reasons (e.g. by realising synergies between the entity and the other entity) from the exercise or conversion of the instrument.

To be substantive, rights also need to be exercisable when decisions about the direction of the relevant activities need to be made. Usually, to be substantive, the rights need to be currently exercisable.

### 2.1.6 Protective Rights

In evaluating whether rights give an entity power over another entity, the entity shall assess whether its rights, and the rights held by others, are protective rights. Protective rights are designed to protect the interests of their holder without giving that party power over the entity to which those rights relate, therefore an entity that holds only protective rights cannot have power or prevent another party from having power over the entity to which those rights relate. Examples of protective rights include but are not limited to:

a) A lender's right to restrict a borrower from undertaking activities that could significantly change the credit risk of the borrower to the detriment of the lender.
b) The right of a party holding a non-controlling interest in an entity to approve capital expenditure greater than that required in the ordinary course of business, or to approve the issue of equity or debt instruments.
c) The right of a lender to seize the assets of a borrower if the borrower fails to meet specified loan repayment conditions.
d) The right of a regulator to reduce or close the operations of entities that are not complying with regulations or other requirements. For example, a pollution control authority may be able to close down activities of an entity that breaches environmental regulations.
e) The right to remove members of the governing body of another entity under certain restricted circumstances.
f) The right of the government to remove tax deductibility for contributions to a not-for-profit entity if the entity significantly changes its objectives or activities.
g) The right of an entity providing resources to a charity to demand that, if the charity were to be liquidated, the net assets of the charity would be distributed to an organisation undertaking similar activities. It is noted that if the entity had the power to determine specifically to where the charity's net assets would be distributed upon liquidation, the entity would have substantive rights in relation to the charity.

### 2.1.7 VOTING RIGHTS

Where an entity has voting or similar rights in respect of another entity, an entity should consider whether those rights give it the current ability to direct the relevant activities of the entity. In making that assessment, an entity considers the following:

1. **Power with a majority of the voting rights**
   An entity that holds more than half of the voting rights of another entity has power in the following situations, unless paragraph 2.1.7(2) applies:
   a) The relevant activities are directed by a vote of the holder of the majority of the voting rights; or
   b) A majority of the members of the governing body that directs the relevant activities are appointed by a vote of the holder of the majority of the voting rights.

2. **Majority of the voting rights but no power**
   An entity does not have power over another entity, even though the entity holds the majority of the voting rights in the other entity, when those voting rights are

not substantive, in accordance with paragraph 2.1.5. For example, an entity that holds more than half of the voting rights in another entity cannot have power if the relevant activities are subject to direction by a government, court, administrator, receiver, liquidator or regulator.

3. **Power without a majority of the voting rights**

An entity can have power even if it holds less than a majority of the voting rights of another entity, for example, through:

a) The power to appoint or remove a majority of the members of the board of directors (or other governing body), and control of the other entity is by that board or by that body (see paragraph 2.1.7(5));
b) A binding arrangement between the entity and other vote holders (see paragraph 2.1.7(6));
c) Rights arising from other binding arrangements (see paragraph 2.1.7(7));
d) The entity's voting rights (see paragraphs 2.1.7(4) and 2.1.7(9));
e) Potential voting rights (see paragraph 2.1.7(10));
f) A combination of (a) – (e).

4. **Special voting rights attaching to ownership interests (Golden Shares)**

An entity may have the right of decisive vote, thus to veto all other voting rights of another entity (also referred to as a "golden share"). Such special voting rights may give rise to power. Usually these rights are documented in the founding documents of the other entity (articles of association), and are designed to restrict the level of voting or other rights that may be held by certain parties. They may also give an entity veto powers over any major change in the other entity, such as the sale of a major asset or the sale of the other entity as a whole. Examples are included in paragraphs 4(a) – 4(b) of Appendix 2.

5. **Control of the board or other governing body**

An entity may have the power to appoint or remove a majority of the members of the board of directors (or other governing body) as a result of binding arrangements, including existing legislation, executive authority, regulation, contractual, or other arrangements. Relevant example is included in paragraph 5 of Appendix 2.

6. **Binding arrangement with other vote holders**

A binding arrangement between an entity and other vote holders can give the entity the right to exercise voting rights sufficient to give it power, even if the entity does not have voting rights sufficient to give it power without the binding arrangement. However, a binding arrangement might ensure that the entity can direct enough

other vote holders on how to vote to enable the entity to make decisions about the relevant activities.

7. **Rights from other binding arrangements**

   Other decision-making rights, specified in binding arrangements, in combination with voting rights, can give an entity the current ability to direct the relevant activities. However, an entity would not control another entity if that other entity were able to determine its policy or program to a significant extent (for example by failing to comply with the binding arrangement and accepting the consequences, or by changing its constitution or dissolving itself).

8. **Economic Dependence**

   Economic dependence, alone, does not give rise to power over an entity for the purposes of this accounting policy. Economic dependence may occur when:

   a) An entity has a single major client and the loss of that client could affect the existence of the entity's operations; or
   b) An entity's activities are predominantly funded by grants and donations and it receives the majority of its funding from a single entity.

An entity may be able to influence the financial and operating policies of another entity that is dependent on it for funding. However, a combination of factors will need to be considered to determine whether the economic dependence is such that the economically dependent entity no longer has the ultimate power to govern its own financial or operating policies. If an economically dependent entity retains discretion as to whether it will accept funding from an entity, or do business with an entity, the economically dependent entity still has the ultimate power to govern its own financial or operating policies. For example, a private school that accepts funding from a government but whose governing body has retained discretion with respect to accepting funds or the manner in which those funds are to be used, would still have the ultimate power to govern its own financial or operating policies. This may be so even if government grants provided to such an entity require it to comply with specified conditions. Although the entity might receive government grants for the construction of capital assets and operating costs subject to specified service standards or restrictions on user fees, its governing bodies may have ultimate discretion about how assets are used. It is also important to distinguish between the operations of an entity and an entity itself. The loss of a major client might affect the viability of the operations of an entity but not the existence of the entity itself. Relevant example is included in paragraph 6 of Appendix 2.

9. **The entity's voting rights**

   An entity with less than a majority of the voting rights has rights that are sufficient to give it power when the entity has the practical ability to direct the relevant activities unilaterally. In assessing whether an entity's voting rights are sufficient to give it power, an entity considers all facts and circumstances, including:

   a) The size of the entity's holding of voting rights, relative to the size and dispersion of holdings of the other vote holders, noting that:
      i. the more voting rights an entity holds, both in absolute terms as well as relatively to other voters, the more likely the entity is to have existing rights that give it the current ability to direct the relevant activities;
      ii. the more parties that would need to act together to outvote the entity, the more likely the entity is to have existing rights that give it the current ability to direct the relevant activities;
   b) Potential voting rights held by the entity, other vote holders or other parties (see paragraph 2.1.7(10));
   c) Rights arising from other binding arrangements (see paragraph 2.1.7(7));
   d) Any additional facts and circumstances that indicate that the entity has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholder's meetings.

   If it is not clear, having considered the factors listed in (a) – (d) above, that the entity has power, the entity does not control the other entity.

   Examples are included in paragraphs 7(a) – 7(b) of Appendix 2.

10. **Potential voting rights**

    Potential voting rights are rights to obtain voting rights of another entity, such as those arising from convertible instruments or options, including forward contracts. When assessing control, an entity considers its potential voting rights as well as potential voting rights held by other parties, to determine whether it has power. These potential voting rights are considered only if the rights are substantive (see paragraph 2.1.5). The entity shall consider the purpose and design of the instrument, as well as the purpose and design of any other involvement the entity has with the other entity.

    Substantive potential voting rights are also considered in combination with other rights. For example, power is indicated when an entity holds 40% of the voting rights of another entity and also holds substantive rights arising from options to acquire a further 20% of the voting rights. Further example is included in paragraph 8 of Appendix 2.

11. **Power when voting or similar rights do not have a significant effect on benefits**
    In assessing the purpose and design of another entity, an entity shall consider the involvement and decisions made at the inception of the other entity as part of its design and evaluate whether the transaction terms and features of the involvement provide the entity with rights that are sufficient to give it power. Being involved in the design of another entity alone is not sufficient to give an entity control of that other entity. However, involvement in the design of the other entity may indicate that the entity had the opportunity to obtain rights that are sufficient to give it power over the other entity and hence the ability to determine the purpose and design of an entity may give rise to power. In the case of an entity established with most (or all) of its relevant activities predetermined at inception, having the ability to determine the purpose and design of an entity may be more relevant to the control assessment than any on-going decision-making rights.
    In addition, an entity may have an explicit or implicit commitment to ensure that another entity continues to operate as designed. Such a commitment may increase the entity's exposure to variability of benefits and thus increase the incentive for the entity to obtain rights sufficient to give it power. This too is an indication that the entity has power. Relevant example is included in paragraph 9 of Appendix 2.

### 2.1.8 RELATIONSHIP WITH OTHER PARTIES

When assessing control, an entity shall consider the nature of its relationship with other parties and whether those other parties are acting on the entity's behalf (i.e. they are "de facto agents"). Such a determination requires judgement, considering not only the nature of the relationship but also how those parties interact with each other and the entity.

Such relationships could also arise from legislative or executive authority that does not meet the definition of a binding arrangement. A party is a de facto agent when the entity has, or those that direct the activities of the entity have, the ability to direct that party to act on the entity's behalf. In these circumstances, the entity shall consider its de facto agent's decision-making rights and its indirect exposure, or rights, to variable benefits through the de facto agent together with its own when assessing control of another entity.

Examples of parties that might act as de facto agents for the entity are:

a) The entity's related parties.
b) A party that received its interest in the other entity as a contribution or loan from the entity making the assessment of control.
c) A party that has agreed not to sell, transfer or limit its interests in the other entity without the entity's prior approval.

d) A party that cannot finance its operations without subordinated financial support from the entity.
e) Another entity for which the majority of the members of its governing body or for which its key management personnel are the same as those of the entity.
f) A party that has a close business relationship with the entity, such as the relationship between a professional service provider and one of its significant clients.

## 2.2 BENEFITS

An entity is exposed, or has rights, to variable benefits from its involvement with an entity being assessed for control, when the benefits that it seeks from its involvement have the potential to vary as a result of the other entity's performance. Benefits to which an entity is exposed, or has rights, from its involvement with an entity being assessed for control can be financial and/or non-financial.

### 2.2.1 FINANCIAL BENEFITS

Financial benefits include returns on investment such as dividends or similar distributions. Examples of financial benefits that an entity may receive from its involvement with another entity are:

a) Dividends, variable interest on debt securities, other distributions of economic benefits;
b) Exposure to increases or decreases in the value of an investment in another entity;
c) Exposure to loss from agreements to provide financial support, including financial support for major projects;
d) Cost savings (e.g. if an entity would achieve economies of scale or synergies by combining the operations or assets of the other entity with its own operations or assets);
e) Residual interests in the entity's assets and liabilities on liquidation of that other entity;
f) Other exposures to variable benefits that are not available to other entities.

The entity assesses whether benefits from another entity are variable and how variable those benefits are on the basis of the substance of the arrangement and regardless of the legal form of the benefits. For example, an entity can hold a bond with fixed interest payments. The fixed interest payments are variable benefits for the purpose of this accounting policy because they are subject to default risk and they expose the entity to the credit risk of the issuer of the bond. The amount of variability (i.e. how variable those benefits are) depends on the credit risk of the bond. Similarly, fixed performance fees for

managing another entity's assets are variable benefits because they expose the entity to the performance risk of the other entity. The amount of variability depends on the other entity's ability to generate sufficient revenue to pay the fee.

### 2.2.2 Non-financial Benefits

Non-financial benefits include advantages arising from scarce resources that are not measured in financial terms and economic benefits received directly by service recipients of the entity. Non-financial benefits can occur when the activities of another entity are in agreement with the objectives of the entity and support the entity in achieving its objectives. Such activities may be undertaken voluntarily or the entity may have the power to direct the other entity to undertake those activities. Non-financial benefits can also occur when two entities have complementary objectives, i.e. the objectives of one entity add to, and make more complete, the objectives of the other entity. Examples of non-financial benefits include:

a) The ability to benefit from the specialised knowledge of another entity;
b) The value to the entity of the other entity undertaking activities that assist the entity in achieving its objectives;
c) Improved outcomes;
d) More efficient delivery of outcomes;
e) More efficient or effective production and delivery of goods and services;
f) Having an asset and related services available earlier than otherwise would be the case;
g) Having a higher level of service quality than would otherwise be the case.

The entity assesses whether benefits from another entity are variable and how variable those benefits are on the basis of the substance of the arrangement and regardless of the legal form of the benefits. For example, an entity may receive benefits as a result of the activities of another entity furthering its objectives. The benefits may be variable benefits for the purpose of this accounting policy because they may expose the entity to the performance risk of the other entity. If the other entity were unable to perform those activities then the entity might incur additional costs, either from undertaking the activities itself or by providing additional funds or other forms of assistance to enable the other entity to continue providing those activities.

## 2.3 LINK BETWEEN POWER AND BENEFITS

### 2.3.1 GENERAL

An entity controls another entity if it not only has power over the entity being assessed for control and exposure or rights to variable benefits from its involvement with the other entity, but also has the ability to use its power to affect the nature or amount of the benefits from its involvement with the entity being assessed for control.

An entity with decision-making rights shall determine whether it is a principal or an agent. An entity shall also determine whether another entity with decision-making rights is acting as an agent for the entity. An agent is a party primarily engaged to act on behalf and for the benefit of another party or parties (the principal(s)) and therefore ***does not control*** the other entity when it exercises its decision-making authority. Thus, sometimes a principal's power may be held and exercisable by an agent, but on behalf of the principal.

### 2.3.2 DELEGATED POWER

It is common for public sector entities to be responsible for carrying out government policy. In some cases they may have the authority to act in their own right, in other cases they may act as an agent for a Minister or another entity. For example:

a) A government department, which is authorised by a Minister to act on the Minister's behalf, might act solely as an agent of the responsible Minister in relation to another entity. In such cases the department would not control the other entity and would not consolidate it.

b) A government department may operate under a delegation of power from a Minister. The department uses its own discretion in making decisions and taking actions and is not subject to direction from the Minister. In such cases the department is acting in its own right and would need to apply the other requirements of this accounting policy to determine whether it controlled another entity. The scope of the department's decision-making authority over another entity would be a significant factor in distinguishing whether it is acting as an agent or as a principal.

c) An entity may establish a trust to carry out specified activities and appoints a trustee. The trustee is responsible for making decisions about the financing and operating activities of the trust in accordance with the trust deed. If the entity can replace the trustee at its discretion, the entity would need to assess whether it controls the trust given that, for example, it would be exposed, or have rights, to variable benefits in terms of the extent to which its objectives are achieved or furthered through the activities of the trust.

An entity may delegate its decision-making authority to an agent on some specific issues or on all relevant activities. When assessing whether it controls another entity, the entity shall treat the decision-making rights delegated to its agent as held by the entity directly. In situations where there is more than one principal, each of the principals shall assess whether it has power over the entity by considering the requirements in paragraph 2.1 of this accounting policy.

### 2.3.3 Determining Whether a Decision Maker is an Agent or a Principal

In determining whether it is an agent or a principal, a decision maker shall consider all of the following factors:

a) The scope of its decision-making authority over the other entity, by considering:
    i. the activities that are permitted according to the decision-making agreement(s) and specified by law, and
    ii. the discretion that the decision maker has when making decisions about those activities.
b) The rights held by other parties. Substantive rights held by other parties may affect the decision maker's ability to direct the relevant activities of another entity. Substantive removal (right to remove the decision maker without cause) or other rights may indicate that the decision maker is an agent.
c) The remuneration to which it is entitled in accordance with the remuneration agreement(s). The greater the magnitude of, and variability associated with, the decision maker's remuneration relative to the benefits expected from the activities of the other entity, the more likely the decision maker is a principal. Consideration should also be given to whether the terms, conditions or amounts included in the remuneration agreement are on an arm's length basis.
d) The decision maker's exposure to variability of benefits from other interests that it holds in the other entity. Holding other interests in another entity indicates that the decision maker may be a principal. In evaluating its exposure to variability of benefits from other interests in the other entity (e.g. investments in the other entity or provision of guarantees with respect to the performance of the other entity) a decision maker shall consider the following:
    i. The greater the magnitude of, and variability associated with, its economic interests, considering its remuneration and other interests in aggregate, the more likely the decision maker is a principal.
    ii. Whether its exposure to variability of benefits is different from that of the other entities that receive benefits from the entity being assessed for control and, if so, whether this might influence its actions. For example, this

might be the case when a decision maker provides forms of credit enhancement to another entity.

Examples are included in paragraphs 10(a) – 10(b) of Appendix 2.

# 3. CONSOLIDATED FINANCIAL STATEMENTS

> *"The financial statements of an economic entity in which the assets, liabilities, net assets/ equity, revenue, expenses and cash flows of the controlling entity and its controlled entities are prepared as those of a single economic entity".* (IPSAS 35)

## 3.1 PRESENTATION OF CONSOLIDATED FINANCIAL STATEMENTS

An entity that is a controlling entity shall present consolidated financial statements, unless it meets ***all*** the following conditions:

1. It is itself a controlled entity and the information needs of users are met by its controlling entity's consolidated financial statements, and all its owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the entity not presenting consolidated financial statements;
2. Its debt or equity instruments are not traded in a public market;
3. It did not file, nor is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and
4. Its ultimate or any intermediate controlling entity produces financial statements that are available for public use and comply with IPSASs, in which controlled entities are consolidated or are measured at fair value through surplus or deficit in accordance with this accounting policy.

A controlling entity that is an investment entity shall ***not*** present consolidated financial statements if it is required, in accordance with paragraph 4 of this accounting policy, to measure all of its controlled entities at fair value through surplus or deficit.

## 3.2 ACCOUNTING REQUIREMENTS

*Consolidation of a controlled entity shall begin from the date the entity obtains control of the other entity and cease when the entity loses control of the other entity.*

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

### 3.2.1 CONSOLIDATION PROCEDURES

The 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 accounting treatment of any related goodwill is dealt with in the Accounting Policy for Public Sector Combinations).
c) Eliminate in full intra-economic entity assets, liabilities, net assets/equity, revenue, expenses and cash flows relating to transactions between entities of the economic entity.

### 3.2.2 REPORTING DATES

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.

When the end of the reporting period of the controlling entity is different from that of a controlled entity, the controlling entity uses the most recent financial statements of the controlled entity adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements.

### 3.2.3 ON-CONTROLLING INTERESTS

A controlling entity shall present non-controlling interests in the consolidated statement of financial position within net assets/equity, separately from the net assets/equity of the owners of the controlling entity.

The entity shall attribute:

a) the surplus or deficit and each gain or loss recognised directly in net assets/equity to the owners of the controlling entity and to the non-controlling interests,
b) the total amount recognised in the statement of changes in net assets/equity to the owners of the controlling entity and to the non-controlling interests, even if this results in a deficit balance of the non-controlling interests.

When the proportion of the net assets/equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the controlled entity. The entity shall recognise directly in net assets/equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the controlling entity.

### 3.2.4 LOSS OF CONTROL

If a controlling entity loses control of a controlled entity, the controlling entity:

a) Derecognises the assets (including any goodwill) and liabilities of the former controlled entity from the consolidated statement of financial position at their carrying amounts at the date when control is lost;
b) Derecognises the carrying amount of any non-controlling interests in the former controlled entity at the date when control is lost (including any gain or loss recognised directly in net assets/equity attributable to them);
c) Recognises any investment retained in the former controlled entity and subsequently accounts for it and for any amounts owed by or to the former controlled entity in accordance with relevant accounting policies. That retained interest shall be remeasured at its fair value at the date when control is lost. The remeasured value at the date that control is lost shall be regarded as the fair value on initial recognition of a financial asset in accordance with the Accounting Policy for Financial Instruments or the cost of initial recognition of an investment in an associate or joint venture, if applicable;
d) Recognises the gain or loss associated with the loss of control attributable to the former controlling interest; and

e) Accounts for all amounts previously recognised directly in net assets/equity in relation to that controlled entity on the same basis as would be required if the controlling entity had directly disposed of the related assets or liabilities. If a revaluation surplus previously recognised directly in net assets/equity would be transferred directly to accumulated surplus/deficit on the disposal of the asset, the controlling entity shall transfer the revaluation surplus directly to accumulated surplus/deficit when it loses control of the controlled entity.

In case a controlling entity loses control of a controlled entity in two or more arrangements (transactions), it may be that the multiple arrangements should be accounted for as a single transaction. In determining whether this is the case, the controlling entity shall consider all the terms and conditions of the arrangements and their economic effects. One or more of the following indicate that the controlling entity should account for the multiple arrangements as a single transaction:

a) They are entered into at the same time or in completion of each other.
b) They form a single transaction designed to achieve an overall commercial effect.
c) The occurrence of one arrangement is dependent on the occurrence of at least one other arrangement.
d) One arrangement considered on its own is not economically justified, but it is economically justified when considered together with other arrangements. An example is when a disposal of an investment is priced below market and is compensated for by a subsequent disposal priced above market.

## 3.3 CONTROL OF SPECIFIED ASSETS

An entity shall consider whether it treats a portion of another entity as a deemed separate entity and, if so, whether it controls the deemed separate entity.

An entity shall treat a portion of another entity as a deemed separate entity ***if and only if*** the following condition is satisfied:

Specified assets of the other entity (and related credit enhancements, if any) are the only source of payment for specified liabilities of, or specified other interests in, the other entity. Parties other than those with the specified liability do not have rights or obligations related to the specified assets or to residual cash flows from those assets. In substance, none of the benefits from the specified assets can be used by the remaining portion of the other entity and none of the liabilities of the deemed separate entity are payable from the assets of the remainder of the other entity. Thus, in substance, all the assets, liabilities and equity instruments of that deemed

separate entity are ring-fenced from the overall other entity. Such a deemed separate entity is called a "silo".

When the above condition is satisfied, an entity shall identify the activities that significantly affect the benefits of the deemed separate entity and how those activities are directed in order to assess whether it has control over that portion of the other entity.

If the entity controls the deemed separate entity, the entity shall consolidate that portion of the other entity. In that case, other parties exclude that portion of the other entity when assessing control of, and in consolidating, the other entity.

## 3.4 CONTINUOUS ASSESSMENT

An entity shall reassess whether it controls another entity if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 2 of this accounting policy.

# 4. INVESTMENT ENTITIES – FAIR VALUE REQUIREMENT

*An investment entity shall measure an investment in a controlled entity at fair value through surplus or deficit in accordance with the Accounting Policy for Financial Instruments.*

An investment entity shall ***not*** consolidate its controlled entities or apply the Accounting Policy for Public Sector Combinations when it obtains control of another entity, except if the investment entity has a controlled entity that is not itself an investment entity and whose main purpose and activities are providing services that relate to the investment entity's investment activities. In such a case the investment entity shall consolidate the controlled entity in accordance with paragraph 3.2 of this accounting policy and apply the requirements of the Accounting Policy for Public Sector Combinations to the acquisition of any such controlled entity.

A controlling entity of an investment entity that is not itself an investment entity shall present consolidated financial statements in which it:

1. measures the investments of a controlled investment entity at fair value through surplus or deficit in accordance with the Accounting Policy for Financial Instruments, and
2. consolidates the other assets and liabilities and revenue and expenses of the controlled investment entity in accordance with paragraph 3.2 of this accounting policy.

## 4.1 DETERMINING WHETHER AN ENTITY IS AN INVESTMENT ENTITY

The definition of an investment entity consists of three elements:

1. Number of investors,
2. Purpose of the entity, and
3. Fair value measurement.

### 4.1.1 NUMBER OF INVESTORS

a) An investment entity may have several investors who pool their funds to gain access to investment management services and investment opportunities that they might not have had access to individually. However, in the public sector an investment entity may be formed by, or for, a single controlling entity that represents or supports the interests of a wider group of investors (e.g. a pension fund, government investment fund or trust).

b) The investors of an investment entity will often have ownership interests in the form of equity or similar interests (e.g. partnership interests), to which proportionate shares of the net assets of the investment entity are attributed. Having different classes of investors, some of which have rights only to a specific investment or group of investments, or which have different proportionate shares of the net assets, does not preclude an entity from being an investment entity.

### 4.1.2 PURPOSE

**1. Demonstrating purpose**

The purpose of an investment entity, as defined in this accounting policy, is to invest solely for returns from capital appreciation, investment revenue (such as dividends or similar distributions, interest or rental revenue), or both. Evidence of an investment entity's purpose can be provided by documents that indicate what the entity's investment objectives are, such as the entity's mandate, constitution, offering memorandum, publications distributed by the entity and other corporate or partnership documents.

An entity that has additional objectives that are inconsistent with the purpose of an investment entity would **not** meet the definition of an investment entity. For example:

a) An investor whose objective is to jointly develop, produce or market products with its investees. The entity will earn returns from the development, production or marketing activity as well as from its investments;
b) An investor whose objectives require it to be aligned with the economic, social or environmental policies of another entity. For example, if an entity is required to align its investment policies with other objectives such as owning certain businesses or improving employment outcomes in a jurisdiction; and
c) An investor whose individual investment decisions have to be ratified or approved by a controlling entity or which is required to follow the direction of a controlling entity. Such ratifications, approvals or decisions are likely to be inconsistent with the purpose of an investment entity.

An investment entity may have a number of ways in which it can demonstrate that its purpose is to invest funds for capital appreciation, investment revenue or both. One way is by holding several investments to diversify its risk and maximise its returns. An entity may hold a portfolio of investments directly or indirectly, for example by holding a single investment in another investment entity that itself holds several investments.

Holding a single investment does not necessarily prevent an entity from meeting the definition of an investment entity. For example, an investment entity may hold only a single investment when the entity:

a) Is in its start-up period and has not yet identified suitable investments and, therefore has not yet executed its investment plan to acquire several investments;
b) Has not yet made other investments to replace those it has disposed of;
c) Is established to pool investor's funds to invest in a single investment when that investment is unobtainable by individual investors (e.g. when the required minimum investment is too high for an individual investor); or
d) Is in the process of being disestablished.

**2. Investment-Related Services and Activities**

An investment entity may provide investment-related services (e.g. investment advisory services, investment management, investment support and administrative services), either directly or through a controlled entity, to third parties as well as to its controlling entity or other investors, even if those activities are substantial to the entity, subject to the entity continuing to meet the definition of an investment entity.

An investment entity may also participate in the following investment-related activities, either directly or through a controlled entity, if these activities are undertaken to maximise

the investment return (capital appreciation or investment revenue) from its investees and do not represent a separate substantial source of revenue to the investment entity:

a) Providing management services and strategic advice to an investee; and
b) Providing financial support to an investee, such as a loan, capital commitment or guarantee.

If an investment entity has a controlled entity that is not itself an investment entity and whose main purpose and activities are providing investment-related services or activities that relate to the investment entity's investment activities to the entity or other parties, it shall consolidate that controlled entity in accordance with paragraph 3.2 of this accounting policy. If the controlled entity that provides the investment-related services or activities is itself an investment entity, the controlling investment entity shall measure that controlled entity at fair value through surplus or deficit in accordance with the Accounting Policy for Financial Instruments.

**3. Exit Strategies**

An entity's investment plans also provide evidence of its purpose. An investment entity does not plan to hold its investments indefinitely, it holds them for a limited period. An investment entity shall have an exit strategy documenting how the entity plans to realise capital appreciation from substantially all of its equity investments and non-financial asset investments, as all of these have the potential to be held indefinitely. An investment entity shall also have an exit strategy for any debt instruments that have the potential to be held indefinitely, for example perpetual debt investments.

Different potential strategies shall be identified for different types of portfolios of investments, including a substantive time frame for exiting the investments. Exit mechanisms that are only put in place for default events, such as a breach of contract or non-performance, are not considered exit strategies for the purpose of this assessment. Examples of exit strategies include the following:

a) For investments in private equity securities, exit strategies include an initial public offering, a private placement, a trade sale of a business, distributions (to investors) of ownership interests in investees and sales of assets.
b) For equity investments that are traded in the public market, exit strategies include selling the investment in a private placement or in a public market.
c) For real estate investments, an exit strategy could be the sale of the real estate through specialised property dealers or the open market.

### 4.1.3 Fair Value Measurement

An investment entity measures and evaluates the performance of substantially all of its investments on a fair value basis. Therefore, an investment entity:

a) Provides investors with fair value information and measures substantially all of its investments at fair value in its financial statements whenever fair value is required or permitted in accordance with accounting policies. In order to meet this requirement, an investment entity shall:
   i. Elect to account for any investment property using the fair value model in the Accounting Policy for Property, Plant and Equipment;
   ii. Elect the exemption from applying the equity method included in the Accounting Policy for Investments in Associates and Joint Ventures for its investments in associates and joint ventures; and
   iii. Measure its financial assets at fair value using the requirements in the Accounting Policy for Financial Instruments.

b) Reports fair value information internally to the entity's key management personnel (as defined in the Accounting Policy for Related Party Disclosures), who use fair value as the primary measurement attribute to evaluate the performance of substantially all of its investments and to make investment decisions.

An investment entity may have some non-investment assets, such as a head office property and related equipment, and may also have financial liabilities. The fair value measurement element of the definition on an investment entity applies to an investment entity's investments. Accordingly, an investment entity need not measure its non-investment assets or its liabilities at fair value.

## 4.2 Judgements and Assumptions

An investment entity shall disclose information about significant judgements and assumptions it has made in determining that it is an investment entity, unless it has **all** of the following characteristics:

a) It has obtained funds from more than one investor (see paragraph 4.1.1(a));
b) It has ownership interests in the form of equity or similar interests (see paragraph 4.1.1(b)); and
c) It has more than one investment (see paragraph 4.1.2(1)).

Relevant example is included in paragraph 11 of Appendix 2.

### 4.3 ACCOUNTING FOR A CHANGE IN INVESTMENT ENTITY STATUS

When an entity ceases to be an investment entity, it shall apply the Accounting Policy for Public Sector Combinations to any controlled entity that was previously measured at fair value through surplus or deficit in accordance with paragraph 4. The date of the change of status shall be the deemed acquisition date. The fair value of the controlled entity at the deemed acquisition date shall represent the transferred deemed consideration when measuring any goodwill or gain from a bargain purchase that arises from the deemed acquisition. All controlled entities shall be consolidated in accordance with paragraph 3.2 of this accounting policy from the date of change of status.

When an entity becomes an investment entity, it shall cease to consolidate its controlled entities at the date of the change in status, except for any controlled entity that shall continue to be consolidated in accordance with paragraph 4. The investment entity shall apply the requirements of paragraph 3.2.4 of this accounting policy to those controlled entities that it ceases to consolidate as though the investment entity had lost control of those controlled entities at that date.

## 5. DISCLOSURE

Disclosure requirements are incorporated in paragraph 3.2 Accounting Requirements of this accounting policy.

## 6. TRANSITIONAL PROVISIONS

1) For the purposes of this accounting policy, the date of initial application is the beginning of the annual reporting period for which this accounting policy is applied for the first time. When this accounting policy is first applied, the entity shall only present the quantitative information required by paragraph 5.1.1(f) of the Accounting Policy for Accounting Policies, Changes in Accounting Estimates and Errors for the annual period immediately preceding the date of initial application of this accounting policy.

2) Except for the case specified in paragraph 1 above, an entity shall apply this accounting policy retrospectively, in accordance with paragraph 2.2 of the Accounting Policy for Accounting Policies, Changes in Accounting Estimates and Errors.

3) At the date of initial application, an entity shall assess whether it is an investment entity on the basis of the facts and circumstances that exist at that date. If, at the date of initial

application, an entity concludes that it is an investment entity, it shall apply the requirements of paragraphs 6.4, 6.5 and 6.6 below instead of paragraphs 6.10 and 6.11.

4) An investment entity shall measure its investment in each controlled entity at fair value through surplus or deficit as if the requirements of this accounting policy had always been effective. The investment entity shall retrospectively adjust both the annual period that immediately precedes the date of initial application and net assets/equity at the beginning of the immediately preceding period for any difference between:

a) The previous carrying amount of the controlled entity; and
b) The fair value of the investment entity's investment in the controlled entity.

The cumulative amount of any fair value adjustments previously recognised directly in net assets/equity shall be transferred to accumulated surplus/deficit at the beginning of the annual period immediately preceding the date of initial application. The investment entity shall use the fair value amounts that were previously reported to investors or to management.

5) If measuring an investment in a controlled entity in accordance with paragraph 6.4 above is impracticable (as defined in the Accounting Policy for Accounting Policies, Changes in Accounting Estimates and Errors), an investment entity shall apply the requirements of this accounting policy at the beginning of the earliest period for which application of paragraph 6.4 above is practicable, which may be the current period. The investor shall retrospectively adjust the annual period that immediately precedes the date of initial application. In case that the beginning of the earliest period for which application of this paragraph is practicable is the current period, the adjustment to net assets/equity shall be recognised at the beginning of the current period.

6) In case that an investment entity has disposed of, or has lost control of, an investment in a controlled entity before the date of initial application of this accounting policy, the investment entity is not required to make adjustments to the previous accounting for that controlled entity.

7) If, at the date of initial application, an entity concludes that it shall consolidate another entity, the entity measures the assets, liabilities and non-controlling interests in that previously unconsolidated entity as if that other entity had been consolidated from the date when the entity obtained control of that other entity on the basis of the requirements of this accounting policy. The entity shall adjust retrospectively the annual period immediately preceding the date of initial application. When the date that control was obtained is earlier than the beginning of the immediately preceding period, the entity shall recognise, as an adjustment to net assets/equity at the beginning of the immediately preceding period, any difference between:

a) The amount of assets, liabilities and non-controlling interests recognised; and
b) The previous carrying amount of the entity's involvement with the other entity.

8) If measuring a controlled entity's assets, liabilities and non-controlling interests in accordance with paragraph 6.7 (a) or (b) is impracticable (as defined in the Accounting Policy for Accounting Policies, Changes in Accounting Estimates and Errors), an entity shall measure the assets, liabilities and non-controlling in that previously unconsolidated entity as if that entity had been consolidated from the deemed acquisition date. The deemed acquisition date shall be the beginning of the earliest period for which the application of this paragraph is practicable, which may be the current period.

9) The entity shall adjust retrospectively the annual period immediately preceding the date of initial application, unless the beginning of the earliest period for which application is practicable is the current period. When the deemed acquisition date is earlier than the beginning of the immediately preceding period, the entity shall recognise, as an adjustment to net assets/equity at the beginning of the immediately preceding period, any difference between:

a) The amount of assets, liabilities and non-controlling interests recognised; and
b) The previous carrying amounts of the entity's involvement with the other entity.

If the earliest period for which application of this paragraph is practicable is the current period, the adjustment to net assets/equity shall be recognised at the beginning of the current period.

10) If, at the date of initial application, an entity concludes that it will no longer consolidate an entity that was previously consolidated in accordance with an accounting policy based on IPSAS 6, the entity shall measure its interest in the other entity at the amount at which it would have been measured if the requirements of this accounting policy had been effective when the entity became involved with, or lost control of, the other entity. The entity shall adjust retrospectively the annual period immediately preceding the date of initial application. When the date that the entity became involved with (but did not obtain control in accordance with this accounting policy), or lost control of, the other entity is earlier than the beginning of the immediately preceding period, the entity shall recognise, as an adjustment to net assets/equity at the beginning of the immediately preceding period, any difference between:

a) The previous carrying amount of the assets, liabilities and non-controlling interests; and
b) The recognised amount of the entity's interest in the other entity.

11) If measuring the interest in the other entity in accordance with paragraph 6.10 above is impracticable (as defined in the Accounting Policy for Accounting Policies, Changes in

Accounting Estimates and Errors), an entity shall apply the requirements of this accounting policy at the beginning of the earliest period for which application of paragraph 6.10 is practicable, which may be the current period. The entity shall adjust retrospectively the annual period immediately preceding the date of initial application, unless the beginning of the earliest period for which application of this paragraph is practicable is the current period. When the date that the entity became involved with (but did not obtain control in accordance with this accounting policy), or lost control of, the other entity is earlier than the beginning of the immediately preceding period, the entity shall recognise, as an adjustment to net assets/equity at the beginning of the immediately preceding period, any difference between:

a) The previous carrying amount of the assets, liabilities and non-controlling interests; and
b) The recognised amount of the entity's interest in the other entity.

If the earliest period for which application of this paragraph is practicable is the current period, the adjustment to net assets/equity shall be recognised at the beginning of the current period.

12) If a controlled entity becomes a first-time adopter later than its controlling entity, except for the controlled entity of an investment entity, the controlled entity shall, in its financial statements, measure its assets and liabilities at the carrying amounts required by IPSAS 33, based on the controlled entity's date of adoption of IPSASs.

13) If a controlling entity becomes a first-time adopter later than its controlled entity, the controlling entity shall, in its consolidated financial statements, measure the assets and liabilities of the controlled entity at the same carrying amounts as in the financial statements of the controlled entity, after adjusting for consolidation and equity accounting adjustments and for the effects of the public sector combination in which the controlling entity acquired the controlled entity. Similarly, if a controlled entity becomes a first-time adopter for its separate financial statements earlier or later than for its consolidated financial statements, it shall measure its assets and liabilities at the same amounts in both financial statements, except for consolidation adjustments.

# 7. EFFECTIVE DATE

This rule shall be effective for annual financial statements covering periods beginning on or after 1 January 2024.

# 8. REFERENCES

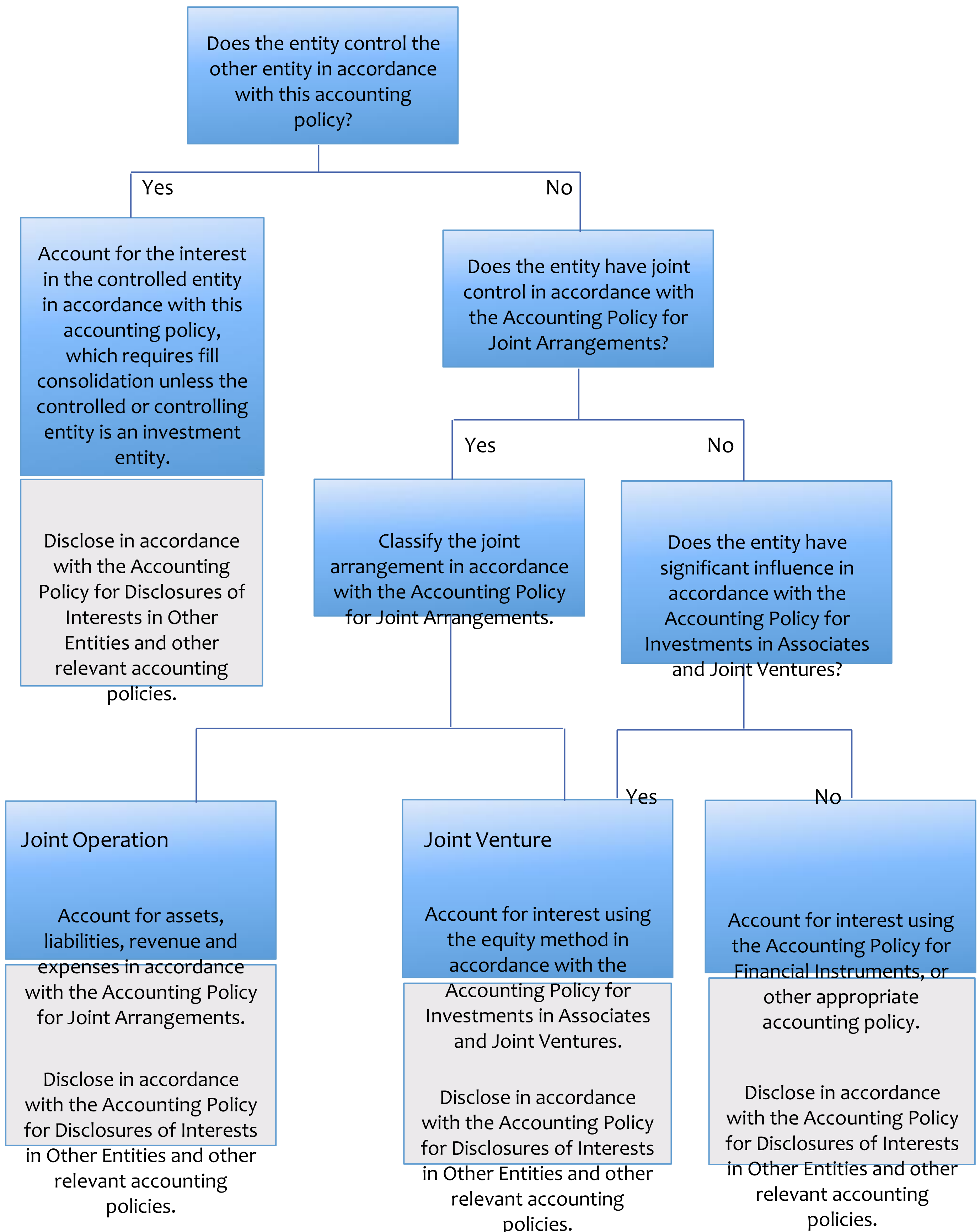
This accounting policy is based on the following IPSAS standards:

IPSAS 33 First – time Adoption of Accrual Basis IPSASs

IPSAS 35 Consolidated Financial Statements

# 9. APPENDICES

## APPENDIX 1: FORMS OF INVOLVEMENT WITH OTHER PARTIES



## APPENDIX 2: EXAMPLES

**1. Regulatory Control**

a) A pollution control authority has the power to close down the operations of entities that are not complying with environmental regulations.

- ❖ The existence of this power does not constitute power over the relevant activities.

b) A city has the power to pass zoning laws to limit the location of fast food outlets or to ban them altogether.

- ❖ The existence of this power does not constitute power over the relevant activities of the fast food outlets.

c) A central government has the power to impose regulatory control on monopolies. A wholly owned government agency has the power to regulate monopolies that are subject to such regulatory control and has established price ceilings for entities that distribute electricity. The central government does not have an ownership interest in the electricity distributors and does not receive financial benefits from the electricity distributors.

- ❖ Neither the central government, nor the government agency, has control as a result of the power to impose regulatory control. Any other powers would need to be separately assessed.

d) A gaming control board (GCB) is a government agency that regulates casinos and other types of gaming in a state, and enforces state gaming legislation. The GCB is responsible for publicising/ communicating rules and regulations that govern the conduct of gaming activities in the state. The rules and regulations stem from legislation. The legislation was passed by the legislature and sets forth the broad policy of the state with regard to gaming, while the rules and regulations provide detailed requirements that must be satisfied by a gaming establishment, its owners, employees, and vendors. The rules and regulations cover a broad range of activity, including licensing, accounting systems, rules of casino games, and auditing.

The GCB also has authority to grant or deny licences to gaming establishments, their ownership, employees and vendors. In order to obtain a licence, an applicant must demonstrate that they possess good character, honesty and integrity. License application forms typically require detailed personal information. Based upon the

type of license being sought, an applicant may also be required to disclose details regarding previous business relationships, employment history, criminal records and financial stability.

- Although the rules and regulations have an impact on how gaming establishments operate, the GCB does not have power over the relevant activities of the gaming establishments. The regulations apply to all gaming establishments and each establishment has a choice as to whether it wishes to engage in gaming or not. The purpose of the gaming legislation and regulations is to protect the public, rather than to establish a controlling interest in the gaming establishments.

### 2. Relevant Activities and Direction of Relevant Activities

Entities A and B, form another entity, entity C, to develop and market a medical product. Entity A is responsible for developing and obtaining regulatory approval of the medical product – that responsibility includes having the unilateral ability to make all decisions relating to the development of the product and to obtaining regulatory approval. Once the regulator has approved the product, entity B will manufacture and market it – entity B has the unilateral ability to make all decisions about the manufacture and marketing of the product. If all the activities – developing and obtaining regulatory approval as well as manufacturing and marketing of the medical product – are relevant activities, entity A and entity B each needs to determine whether they are able to direct the activities that ***most*** significantly affect the benefits from entity C. Accordingly, entity A and B each need to consider whether developing and obtaining regulatory approval or the manufacturing and marketing of the medical product is the activity that most significantly affects the benefits from entity C and whether they are able to direct that activity.

- In determining which entity has power, entities A and B would consider:
  1. The purpose and design of entity C;
  2. The factors that determine the surplus, revenue and value of entity C as well as the value of the medical product;
  3. The effect of the decision-making authority on entity C's performance with respect to the factors in (b); and
  4. Their exposure to variability of benefits from entity C.

In this particular example, the entities should also consider:

i. The uncertainty of, and effort required in, obtaining regulatory approval (considering their record of successfully developing and obtaining regulatory approval of medical products); and
ii. Which entity controls the medical product once the development phase is successful.

**3. Rights that Give an Entity Power over another Entity**

a) A government has the right to appoint and remove the majority of members of a statutory body. This power has been used by previous governments. The current government has not done so because it does not wish, for political reasons, to be regarded as interfering in the activities of the statutory body.

- ❖ In this case the government still has substantive rights, even though it has chosen not to use them.

b) An entity being assessed for control has annual shareholder meetings at which decisions to direct the relevant activities are made. The next scheduled shareholders' meeting is in eight months. However, shareholders that individually or collectively hold at least 5 per cent of the voting rights can call a special meeting to change the existing policies over the relevant activities, but a requirement to give notice to the other shareholders means that such a meeting cannot be held for at least 30 days. Policies over the relevant activities can be changed only at special or scheduled shareholders' meetings. This includes the approval of material sales of assets as well as the making or disposing of significant investments.

i. An entity holds a majority of the voting rights in the other entity.

- ❖ The entity's voting rights are substantive because the entity is able to make decisions about the direction of the relevant activities when they need to be made. The fact that it takes 30 days before the entity can exercise its voting rights does not stop the entity from having the current ability to direct the relevant activities from the moment the entity acquires the shareholding.

ii. An entity is party to a forward contract to acquire the majority of shares in the other entity. The forward contract's settlement is in 25 days.

- ❖ The existing shareholders are unable to change the existing policies over the relevant activities because a special meeting cannot be held for at least 30 days, at which point the forward contract will have been settled. Thus, the entity has rights that are essentially equivalent to the majority shareholder in example 3(b)(i) above (i.e. the entity holding the forward contract can make

decisions about the direction of the relevant activities when they need to be made). The entity's forward contract is a substantive right that gives the entity the current ability to direct the relevant activities even before the forward contract is settled.

iii. An entity is a party to a forward contract to acquire the majority of shares in the other entity, with no other related rights over the other entity. The forward contract's settlement date is in six months.

- ❖ The entity does not have the current ability to direct the relevant activities. The existing shareholders have the current ability to direct the relevant activities because they can change the existing policies over the relevant activities before the forward contract is settled.

**4. Power without a Majority of the Voting Rights and Special Voting Rights Attaching to Ownership Interests**

a) A central government has privatised a company and, in order to protect its national interests, it has used a "golden share" mechanism. The "golden share" does not have any value or give any percentage rights to the capital of the company. The golden share states that control of the company, or a 24 percent stake in the company cannot be sold without the permission of the central government.

- ❖ The central government has protective rights, not substantive rights.

b) A central government sold all of its shares in a company, but kept a golden share (with a nominal value of one currency unit). The golden share granted the Secretary of State (as the holder of the share) a 15 percent shareholding in the company, and consequently the ability to block any potential takeover of the business. It also required that the chairman of the board and the chief executive be citizens of the country. The rationale for the golden share was to protect the company from an overseas acquisition, principally on the grounds of national security.

- ❖ The central government has protective rights, not substantive rights.

**5. Control of the Board or Other Governing Body**

A national museum is governed by a board of trustees who are chosen by the government department responsible for funding the museum. The trustees have freedom to make decisions about the operation of the museum.

- The department has the power to appoint the majority of the museum's trustees. The department has the potential to exercise power over the museum.

**6. Economic Dependence**

A research institution is one of the many institutions that receive the majority of their funding from a central government. The institutions submit proposals and the funding is allocated through a tendering process. The research institution retains the right to accept or decline funding.

- The central government does not control the research institution because the research institution can choose to decline funding from the government, seek alternative sources of funding or cease to operate.

**7. Voting Rights**

a) An entity acquires 48 per cent of the voting rights of another entity. The remaining voting rights are held by thousands of shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders have any arrangements to consult any of the others or make collective decisions. When assessing the proportion of voting rights to acquire, on the basis of the relative size of the other shareholdings, the entity determined that a 48 per cent interest would be sufficient to give it control.

   - In this case, on the basis of the absolute size of its holding and the relative size of the other shareholdings, the entity concludes that it has a sufficiently dominant voting interest to meet the power criterion without the need to consider any other evidence of power.

b) Entity A holds 40 per cent of the voting rights of another entity and twelve other investors each hold 5 per cent of the voting rights of the other entity. A shareholder agreement grants Entity A the right to appoint, remove and set the remuneration of management responsible for directing the relevant activities. To change the agreement, a two-thirds majority vote of the shareholders is required.

   - In this case, Entity A concludes that the absolute size of its holding and the relative size of the other shareholdings alone are not conclusive in determining whether it has rights sufficient to give it power. However, Entity A determines that its contractual right to appoint, remove and set the

remuneration of management is sufficient to conclude that it has power over the other entity. The fact that Entity A might not have exercised this right or the likelihood of Entity A exercising its right to select, appoint or remove management shall not be considered when assessing whether Entity A has power.

**8. Potential Voting Rights**

Entity A holds 70 per cent of the voting rights of another entity. Entity B has 30 per cent of the voting rights of the other entity as well as an option to acquire half of Entity A's voting rights. The option is exercisable for the next two years at a fixed price that is deeply out of the money, and is expected to remain so for that two-year period (Out of the money (OTM) is a term used to describe a call option – option to buy – with a strike price that is higher than the market price of the underlying asset, or a put option – option to sell – with a strike price that is lower than the market price of the underlying asset.). Entity A has been exercising its votes and is actively directing the relevant activities of the other entity.

- ❖ In such a case, Entity A is likely to meet the power criterion because it appears to have the current ability to direct the relevant activities. Although Entity B has currently exercisable options to purchase additional voting rights (that, if exercised, would give it a majority of the voting rights in the other entity), the terms and conditions associated with those options are such that the options are not considered substantive.

**9. Power when Voting or Similar Rights do not have a Significant Effect on Benefits**

Five local authorities create a separate company to deliver shared services to participating authorities. The company operates under contract to these local authorities. The company's major objective is the provision of services to these local authorities.

The company is owned by all of the participating local authorities with each owning one share and allowed one vote. The chief executive of each local government is permitted to be a board member of the company. The board of the company is responsible for strategic direction, approval of business cases and monitoring of performance.

For each shared activity there is an advisory group that is responsible for operational management and decision-making in relation to that activity. Each advisory group consists of one representative from each local government. The benefits of the shared services arrangements are:

- Improved levels and quality of service;
- A co-ordinated and consistent approach to the provision of services;
- Reductions in the cost of support and administrative services;
- Opportunities to develop new initiatives; and
- Economies of scale resulting from a single entity representing many councils in procurement.

If further shared service activities are established that lead to the need for further capital, the company will either issue a new class of equity instrument or will form a controlled entity to hold the interest in the new assets.
The company covers its costs in two ways. It retains a percentage of savings from its bulk purchasing activities and it charges an administrative transaction cost of services provided to the local authorities.

- ❖ None of the local authorities individually controls the company. In deciding how to account for its interest in the company each local authority would also need to consider whether it is a party to a joint arrangement, as defined in the Accounting Policy for Joint Arrangements.

**10. Link between Power and Benefits**

a) A statutory body is established under legislation to deliver services to the community. The statutory body has a governing council that oversees the body's operations and is responsible for its day-to-day operations. The Minister of Health for the provincial government appoints the statutory body's governing council and, subject to the Minister's approval, the statutory body's governing council appoints the chief executive of the body.
The provincial government's Health Department acts as the "system manager" for the provincial public health system. This role includes:
    - Strategic leadership, such as the development of provincial-wide health service plans;
    - Directions for the delivery of health services, such as entering into service agreements, capital works approval and management of provincial-wide industrial relations, including employment terms and conditions for the statutory body's employees; and
    - Monitoring of performance (e.g. quality of health services and financial data) of the authority and taking remedial action when performance does not meet specified performance measures.

The Minister's approval is specifically required for the following major decisions:

- Entering into service agreements within the body;
- Issuing binding health service directives;
- Finalisation of health service plans and capital works planning; and
- Employment and remuneration of the statutory body's executive staff.

The Health Department receives all its operating and capital funding from the provincial government.

- ❖ Based on the facts and circumstances outlined above, the Health Department generally acts as an agent of the Minister in relation to the statutory body. This is evident from the restricted decision-making authority held by the Department. The Health Department does not control the statutory body.
- ❖ As the Minister appoints the statutory body's governing council and approves the major decisions affecting the body's activities, the Minister has the power to direct the relevant activities of the body. Assuming that the other control criteria (variable returns and link between power and benefits) are satisfied, as would be expected, then the Minister would control the statutory body. As a result, the statutory body would be consolidated in the provincial government's whole of government general purpose financial statements.

b) A sovereign wealth fund (the fund) is a constitutionally established permanent fund, managed by a government corporation. Legislation specifies that the fund is entitled to receive at least 25% of the proceeds from oil sales. The fund sets aside a certain share of these revenues to benefit current and future generations of citizens.
The corporation manages the assets of both the fund and certain other state investments and is remunerated for doing so. The corporation may not spend the fund revenue. Decisions on spending the fund revenue are made by the Parliament. Each year, the fund's revenue is split between operating expenses and an annual payment to residents that meet certain criteria specified in legislation.

- ❖ The corporation does not control the sovereign wealth fund. It acts solely as an agent.

**11. Investment Entities**

Government Corporation A was established with the principal activity of providing equity finance to both existing and new enterprises. Its investment objective is to seek capital appreciation and returns. All acquisitions are made on that basis. The strategy of the Corporation is to increase the fair value of investments in order to realise a gain on disposal. Management assesses and monitors fair value of the

investments on a regular basis. The Corporation regularly disposes of investments when they reach a certain stage of maturity so as to provide funds for ongoing investment opportunities. Any surplus is distributed to the government in the form of dividends.

The Corporation also provides investment related services to the government regarding the government's policies for assisting entities in financial distress. It acts as an agent in managing and implementing some of the government's business incentive schemes. The Corporation is not exposed to any losses or risks as a result of its involvement with these schemes.

- ❖ The Corporation is an investment entity. It meets all three aspects of the definition of an investment entity.