

30 June 2015

Chief Executive  
External Reporting Board  
PO Box 11250  
Manners St Central  
Wellington 6142

Dear Sir


**NZASB Invitation to Comment on Exposure Draft NZASB 2016-1-5**

We are pleased to comment on the proposals set out in the NZASB Invitation to Comment *Exposure Drafts NZASB 2016-1-5: Interests in Other Entities* (EDs 2016-1-5). We are encouraged by the NZASB's work to align Public Benefit Entity (PBE) Standards to the latest standards issued by the International Public Sector Accounting Standards Board (IPSASB). We believe that, because the proposals are based on the most recent conceptual thinking on control, joint control and significant influence, they provide more comprehensive guidance for what can be a complex area of accounting. We also believe there is a significant benefit to aligning financial reporting for PBEs and for-profit entities, especially for mixed groups.

We have responded to your specific questions in the appendix attached.

Please do not hesitate to contact us should you have any queries. We also would be happy to meet with you to discuss our comments further.

Yours faithfully  
Ernst & Young Limited



Simon O'Connor  
Managing Partner - Assurance

## Appendix A - Response to specific ITC questions

### ED NZASB 2016-1 PBE IPSAS 34 *Separate Financial Statements*

**1. Do you agree that no substantive changes to IPSAS 34 are required to make it suitable for application by PBEs in New Zealand? If you disagree, please describe the additional changes that you consider to be appropriate.**

Yes, we agree that there should be no substantive changes to IPSAS 34 for PBEs in New Zealand.

### ED NZASB 2016-2 PBE IPSAS 35 *Consolidated Financial Statements*

**2. Do you consider that the IPSASB's reasons for retaining investment entity accounting in the financial statements of a non-investment controlling entity are relevant for both public sector and not-for-profit public benefit entities in New Zealand? If you do not agree, please explain why.**

We agree with the proposals to retain investment entity accounting in the financial statements of non-investment entity parent PBEs. While we understand the International Accounting Standards Board's (IASB's) reasons for not allowing the exemption to flow up to a non-investment entity parents, we also support the IPSASB's reasoning for allowing the fair value accounting to be retained in the consolidated financial statements of a non-investment entity parent. This proposal will decrease the cost of preparing financial statements as well provide users with useful fair value information.

We are comfortable that in the public sector there is sufficient level of scrutiny to ensure structuring or off balance sheet leveraging is not a pervasive issue. However, we do have some concerns that, in the NFP sector, the existing mechanisms in place for review and monitoring of entities are not as robust as in the public sector. To this end, we believe the NZASB should monitor the use of the investment entity exemption in the NFP sector to ensure structuring of entities is not occurring in order to avoid consolidation.

**3. Do you agree with how we have proposed to modify IPSAS 35 by including more guidance on predetermination (see paragraphs 21, 29.1, 35.1, AG8.1, AG53 and Example 29A)? If you do not agree, please explain why.**

We agree with the additional guidance and emphasis placed on the consideration of the purpose and design of an entity in determining control. In particular, we believe this additional guidance will be useful in the NFP sector. Such entities often have involvement with establishing entities with predetermined policies and objectives and, in such situations, determining control can be difficult.

Often when determining control, preparers focus on who makes the day-to-day decisions of the entity, without considering the fact that decisions about the relevant activities have been predetermined at the outset. Therefore, we believe the proposed guidance will be useful to help entities to determine control in such circumstances.

Refer to our response to Q11 below for additional consideration of consolidation in the NFP sector.

We note the reason for the addition to paragraph AG53 is unclear. It seems unnecessary to include the added sentence over and above what the existing amended paragraphs already cover. We suggest this additional wording is redrafted to be clear what new information or guidance the sentence is trying to highlight.

**4. Do you agree with the proposal to include integral application guidance on network and partner agreements in PBE IPSAS 35 (paragraphs AG31.1 to AG31.7)? If you do not agree, please explain why.**

We believe the guidance added in AG 31.1 - 31.7 is useful to assist entities to determine control in these situations. Based on our experience in the NFP space, we are aware of entities looking to analogise to the franchise/network agreement scenario to argue that control does not exist. Therefore, the inclusion of this guidance is useful to clarify when control arises. The guidance makes it clear that in a true network / partner agreement, the "franchisee" is operating to meet its own objectives rather than the objectives of the

“franchisor”. We note, the original guidance in PBE IPSAS 6 para AG 15 referred to the ability of a franchisee to withdraw from the agreement and continue operating its business. We think this guidance should be carried over into the amendments in PBE IPSAS 35 AG 31 (possibly AG 31.6) to make this point clear.

We believe it would be useful if the NZASB included an example in order to demonstrate a situation where control did arise and one where it doesn't. The example could highlight a fact pattern where entities were either operating for their own objectives or for the same objective, or situations where there was financial dependency between the two entities (for example the “franchisor” funding losses of the “franchisee”). Refer to our response to Q11 below also for further consideration.

**5. Do you agree with the other proposed modifications to IPSAS 35 in PBE IPSAS 35? If you disagree, please provide reasons and indicate the nature of any additional modifications that you consider to be appropriate.**

We are comfortable with the other proposed modifications to IPSAS 35. Guidance on mixed groups is important in New Zealand as the issue is likely to be pervasive in both the public sector and for NFPs.

#### **ED NZASB 2016-3 PBE IPSAS 36 *Investments in Associates and Joint Ventures***

**6. Do you agree that no substantive changes to IPSAS 36 are required to make it suitable for application by PBEs in New Zealand? If you disagree, please describe the additional changes that you consider to be appropriate.**

Yes, we agree that there should be no substantive changes to IPSAS 36 for PBE's in New Zealand.

#### **ED NZASB 2016-4 PBE IPSAS 37 *Joint Arrangements***

**7. Do you agree with the proposed modifications to IPSAS 37 in PBE IPSAS 37? If you disagree, please provide reasons and indicate the nature of any additional modifications that you consider to be appropriate.**

Yes, we agree with the proposed modifications to IPSAS 37. We see no reason why the NZASB should not amend PBE IPSAS 37 to include the latest guidance on accounting for the acquisition of an interest in a joint operation that constitutes a business. The guidance will ensure consistence in accounting for such transactions.

#### **ED NZASB 2016-5 PBE IPSAS 38 *Disclosure of Interests in Other Entities***

**8. Do you agree that no substantive changes to IPSAS 38 are required to make it suitable for application by PBEs in New Zealand? If you disagree, please describe the additional changes that you consider to be appropriate.**

Yes, we agree that there should be no substantive changes to IPSAS 38 for PBE's in New Zealand

#### **General**

**9. Do you agree with the Reduced Disclosure Regime concessions proposed in the EDs? If you disagree, please provide reasons and indicate any additional concessions that you consider would be appropriate.**

We agree with the proposed disclosure concessions. We agree with aligning the disclosure concessions to the for-profit accounting standards. This should be kept consistent until the NZASB has completed its review of the RDR regime.

**10. Do you agree with the proposal that the final PBE Standards should have an effective date of 1 January 2019, with earlier application permitted?**

Yes, we agree with the proposed timing of adoption of the PBE Standards. In responding to this question, we have assumed that the NZASB will aim to issue the final standards as soon as possible, hopefully during 2016. This will give entities sufficient time to understand the implications and apply them to their opening balance sheet positions (i.e. 1 January 2018). Public sector entities with 30 June balance dates will get an added 6 months. Therefore, on the assumption the final standards are issued during 2016, the effective date seems reasonable.

#### **11. Do you have any other comments on the EDs?**

We have the following additional comment on the proposals. Our experience to date has highlighted the difficulty in determining control in the NFP sector. This difficulty can arise for a number of reasons including confusion or uncertainty around the structure of a group of related entities given there is often no direct ownership, the founding documents may be outdated or unclear, or the operations of the entity do not reflect the actual requirements of the founding documents.

Prior to the recent change to the financial reporting framework in New Zealand, many NFP entities have not had to consider whether they control other entities they are involved with. However, now that many of these entities have a requirement to prepare financial statements in accordance with PBE Standards, they are struggling to determine who to include within the reporting entity.

In introducing PBE IPSAS 35, we see this as an opportunity to look to address some of the key areas of confusion that NFPs currently face. The key areas where we see entities struggle include:

- ▶ The NFP entity believing that a governing body (for example a national body) does not control the local entities; instead the local entities control the governing body via their ability to vote and appoint members to the governing body. In this situation, the NFP entity might argue there is no control and thus consolidated financial statements should not be prepared.
- ▶ A belief that when local or regional entities, for example, have a high degree of autonomy in the day-to-day decision making of the entity, they are determining their own objectives (including determining their own relevant activities) and thus are not controlled by the national governing body. The local entity may determine how local funding is sourced, the day-to-day activities they will complete and how to spend money. Yet the overarching governing body may have established the overall objectives that entity must achieve and a governance framework for achieving those objectives (including key financial and operating policies), with the day-to-day activities restricted to achieving that goal within the established governance framework. What is essentially taking place is a group of entities are working towards a common goal and the best way to achieve this is through local entities.
- ▶ The overarching governing body is seen as just an administrative body, established to assist the local entities operate effectively and that governing body has no decision making power, yet it is this governing body that has the ability to establish and remove the local entities.
- ▶ Often a group of NFP entities are acting as one economic entity, with the same objectives and goals, however there may be no 'parent' or controlling entity.

We believe the NZASB should consider the points raised above and determine whether additional guidance could be included to ensure these issues are clearly articulated. We note that the inclusion of the 'predetermined activities' guidance will be useful in certain situations in assisting entities to determine control, however, we believe additional examples could be useful to make it clear.

PBE IPSAS 6 included specific guidance around a youth group and this provided useful guidance given it highlighted the link between the common objectives of the local entities. We suggest something similar to the youth group or even a church may be useful.

Further, a discussion of situations where there is a group of entities with no 'parent' entity could be useful to assist NFP entities understand when consolidated financial statements should be prepared.

We note that additional guidance in PBE IPSAS 6 also included consideration of Trusts and determining whether control existed or not. The guidance on the role of settlor and beneficiary is useful in the New

Zealand context as these terms are well understood by preparers. Therefore, we suggest including this in PBE IPSAS 35 also.

***Minor edits***

We note that paragraph 2.2 is added and refers to disclosure concessions. However the concession in PBE IPSAS 35 is to the presentation of consolidated financial statements. We believe the wording should be amended to refer to presentation rather than disclosure.