

Control in the Not-for-Profit Public and Private Sectors

Issues Raised in Research and Technical Enquiries

Objective

This agenda paper outlines how AASB 10 might be applied in respect of control issues identified by Bryan Howieson during his research and by staff through technical enquiries.

Background

Outlined below is an overview of the key interpretation issues relating to a not-for-profit entity's control of an entity identified (1) by Bryan Howieson during his research, and (2) in technical issues received by the AASB staff, together with the AASB staff's analysis of whether these issues are adequately addressed in AASB 10 *Consolidated Financial Statements*. Where we do not think the issues are adequately addressed, we suggest complementary Aus paragraphs.

Definition of control per AASB 127 – *the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.*

Definition of control per AASB 10 – *an investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.*

Although power remains an element of control, the focus is no longer on the power to govern, and power is only one of three components which must be present for control to exist. In addition, AASB 10 now includes many application guidance paragraphs, which further explain the concept of power and assist in the determination of whether an investor has power.

(1) Research Findings

(a) **'the power to govern' component of control**

- Four key issues were raised in regard to interpreting 'the power to govern' in practice:
 - i. **Absence of ownership instruments** and the difficulty in determining whether the 'power to govern' exists in the absence of ownership instruments.
 - Paragraph 11 of AASB 10 notes that power arises from rights. The paragraph notes that sometimes this is straightforward and may be obtained directly from voting rights. However, the third sentence of paragraph 11 further states that the assessment can be more complex and requires more than voting rights to be considered, for example when power results from one or more contractual arrangements. We think this third sentence is broad enough to cover NFP circumstances. However, we suggest including an Aus paragraph to refer explicitly to statutory or other arrangements, to augment the example of contractual arrangements in paragraph 11. See paragraph Aus11.1.
 - ii. **Pervasive authority of governments** and the difficulty in discerning which of a government's powers are pertinent to the control question.

- Though this issue is not directly addressed in AASB 10, the Standard provides far more detailed application guidance than the superseded AASB 127. The Standard clarifies that to have power over an investee, an investor must have existing rights that give it the current ability to direct the relevant activities. Therefore, staff believe the guidance in AASB 10 is adequate to assist a government in determining whether the power held by the government satisfies the power criterion in AASB 10. However, we suggest including a number of Aus paragraphs in the section of the Standard that addresses protective rights. We believe these paragraphs (AusB26.1, AusB27.1 and AusB28.1) will assist a not-for-profit entity in determining whether rights held give it power over the investee or are only protective rights.
 - iii. **Regulatory power** and whether this gives a government the ‘power to govern’.
 - Regulatory power is not directly addressed in AASB 10, however the concept of ‘protective rights’ is addressed, in detail. We think the concept of regulatory power is similar to ‘protective rights’ and suggest the addition of Aus paragraphs to make this clear. See paragraphs AusB26.1 and AusB28.1.
 - iv. **Special purpose/auto-pilot entities** and the difficulty in determining whether the establishing government has an ongoing ‘power to govern’.
 - Special purpose entities are not referred to explicitly in AASB 10, however paragraph B53 in particular does address the situation in which an investee is designed so that the direction of its activities and its returns are predetermined unless and until particular circumstances arise or events occur. We think a not-for-profit entity could apply the guidance in paragraph B53 in determining whether an entity controls such an entity and therefore no Aus paragraph is needed.
- (b) **‘the financial and operating policies’ component of control**
- Two key issues were raised in regard to interpreting ‘the financial and operating policies’ in practice:
 - i. **Financial dependence** and the difficulty in determining the relationship of financial dependence to ‘the financial and operating policies’.
 - The application guidance in AASB 10 addresses “economic dependence”. Paragraph B40 notes “... in the absence of any other rights, economic dependence of an investee on the investor ... does not lead to the investor having power over the investee.” Therefore, consistent with paragraph B40, an entity is required to assess the rights it holds in assessing whether it controls another entity and cannot rely solely on the fact that another entity is financially dependent on it.
 - The suggested paragraph AusB10.1 illustrates that a government may not have the current ability to direct the relevant activities of entities that are financially dependent on government funding.
 - ii. **Relationship between governments and universities** and whether this component adequately addresses that relationship.
 - Staff believe this issue has been addressed with the addition of the example at paragraph AusB10.1 that addresses situations in which an investee may be financially dependent on an investor however, due to the

rights of other parties in relation to the investee, this does not always result in the investor having power over an investee. Universities are included as an example.

(c) 'so as to obtain benefits from its activities' component of control

➤ Two key issues were raised in regard to interpreting the concept of 'so as to obtain benefits from its activities' in practice:

i. The nature of benefits (direct vs. indirect)

- The term 'benefits' is not used in the definition of control in AASB 10, instead the term 'returns' is used. The IASB has stated the term returns is more appropriate as it can indicate both positive and negative returns whilst the term 'benefits' indicates only positive returns. The IASB has stated that its intention is a broad definition of returns, including both direct financial returns and also synergistic returns (paragraph BC63).
- We note that the examples in AASB 10 and the application guidance are very focused on financial returns. Therefore, to address this issue staff suggest the addition of an Aus paragraph that provides examples of returns in the not-for-profit sector. The draft Aus paragraph clarifies that returns in the not-for-profit sector can take the form of financial or non-financial returns, including the meeting of social objectives. See paragraphs Aus4.4, Aus16.1 and AusB57.1.

ii. The relationship of benefits to objectives, for example in relation to trusts.

- We acknowledge the difficulty a not-for-profit entity may face in interpreting not only the term 'returns' but other terms used throughout the Standard, such as investee, investor, and variable returns. Therefore, we suggest adding an Aus paragraph to AASB 10 (paragraph Aus4.4) in the Scope section, that acknowledges that many of the terms used in the Standard have a for-profit focus and provides a not-for-profit context for the principal terms. In addition, paragraph Aus4.4 illustrates that the term 'returns' could include non-financial benefits such as the achievement or furtherance of objectives. Furthermore, we also suggest adding paragraph AusB57.1, which provides examples of returns in the not-for-profit sector including financial and non-financial benefits.
- Paragraph Aus4.4 does not indicate that two not-for-profit entities having common objectives results in one entity controlling the other – 'returns' are just one element of control.

(d) Accounting consequences

i. Single line vs. line-by-line consolidation

- The accounting requirements and consolidation procedures in AASB 10 have not changed from those set out in AASB 127. The requirement to combine the financial statements of controlled entities using line-by-line consolidation remains.
- The focus of Phase 2 of the project is to adapt AASB 10 for not-for-profit entities rather than proposing fundamental changes to the requirements that deviate from AASB 10.

(2) Technical Issues Received

Staff have received the following significant technical issues relating to control in the not-for-profit sector under AASB 127.

Query 1

Interpretation of Aus paragraphs Aus17.2 and Aus17.7. The query was in relation to determining whether a government department controls a statutory body when they are in the same Ministerial portfolio.

Application in AASB 10

AASB 10, unamended, does not address this concern. However, with the addition of the suggested Aus paragraphs to AASB 10, staff are satisfied this issue would be addressed. Paragraph Aus11.1 is based on the current paragraph Aus17.2, modified to remove the list of entities that may hold power over an investee. In addition, staff have not proposed incorporating the reporting entity aspects of paragraph Aus17.7 into AASB 10.

Query 2

Should a subsidiary be consolidated when the entity does not hold any ownership interest? The entity controls the financial and operational policies of the other entity.

Application in AASB 10

AASSB 10 does not require an investor to hold an ownership interest in an investee as a condition of control. The components of control under AASB 10 would need to be assessed in order to conclude whether the investor controls the investee.

Query 3

Does a not-for-profit church denomination control related church agencies? The church may have the capacity to control the majority of seats on the agency boards, but would not use that influence to garner benefits.

Application in AASB 10

Staff consider applying the guidance in AASB 10 would assist in addressing this issue. Judgement will be required.