

**Australian Implementation Guidance for NFP Entities
re Control and Structured Entities**

ISSUES PAPER

IMPLEMENTATION GUIDANCE SWEEP ISSUES

This Issues Paper has been prepared by AASB staff to identify sweep issues that should be addressed by the Board prior to finalising the ballot draft of the authoritative Australian implementation guidance to assist not-for-profit (NFP) entities to apply Accounting Standards AASB 10 *Consolidated Financial Statements* and AASB 12 *Disclosure of Interests in Other Entities*.

Agenda paper 15.1 provides an overview and background to this project. IG paragraph references in this Issues Paper refer to the Pre-Ballot Draft of Accounting Standard AASB 2013-X *Amendments to Australian Accounting Standards – Implementation Guidance for Not-for-Profit Entities – Consolidated Financial Statements and Structured Entities*.

Issue 1 Independent Statutory Office Holders (paragraph IG10)

Several Board members suggested that this paragraph should better explain the rationale for a government controlling the organisation assisting an independent statutory office holder. The proposed amended text of the paragraph is as follows, marked up from the pre-ballot draft text:

IG10 A not-for-profit investor can have power over an investee even if it does not have responsibility for the day-to-day operation of the investee or the specific manner in which prescribed functions are performed by the investee. For example, legislation governing the establishment and operation of an independent statutory office (such as an auditor-general or the judiciary) sets out the broad parameters within which the office holder is required to operate, and results in the office holder operating in a manner consistent with the objectives set by the legislation. Whilst the holders of an independent statutory office are to act independently in discharging their responsibilities, the government typically provides the organisations that assist the statutory office holders in fulfilling their responsibilities. In such cases, the relevant activities of the organisations, including providing technical services to the statutory office holders, are directed by the government by, for example, the government approving the budgets and determining the employment conditions of the key management personnel of the organisations. Therefore, subject to other facts and circumstances, assuming the other control criteria are also satisfied, the organisations assisting the independent statutory office holders would be controlled by the government and would be consolidated into the whole of government general purpose financial statements.

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Question for the Board

Q1 Do members agree with the revised approach regarding independent statutory office holders?

Issue 2 Substantive and Protective Rights

The issue raised for discussion as a sweep issue is whether the rights referred to in various parts of the draft implementation guidance have been identified as substantive or protective rights consistently with the requirements of AASB 10. Two Board members commented on the classification of rights in the pre-ballot draft of the implementation guidance.

One of the Board members commented in respect of the Local Government example (Example IG3) that the following two rights of the State Government should be classified as protective rights instead of substantive rights:

- approve (or veto) investment by the Council in types of financial instruments not already approved under the Act; and
- make guidelines concerning the Council's procurement policy or the provision of services by the Council so as to best meet the needs of the local community.

Another Board member commented on the Local Government example that the following rights of the State Government should be classified as protective rights instead of substantive rights:

- approve (or veto) investment by the Council in types of financial instruments not already approved under the Act; and
- approve (or veto) Council entering into an entrepreneurial endeavour that exceeds 5% of the Council's revenue from rates and charges.

Thus, both Board members questioned the classification of the rights re new types of financial investments, but differed in respect of the second right that they queried.

The second Board member also questioned some other classifications in the draft guidance. These are set out in the table below, following a summary of the requirements in AASB 10 regarding substantive and protective rights.

Requirements in AASB 10

The distinction between substantive and protective rights is not entirely clear in AASB 10. Substantive rights are not explicitly defined. Protective rights are defined in Appendix A of AASB 10 as rights designed to protect the interest of the holder without giving that party power over the entity to which the rights relate. Protective rights are further described in paragraph B26 as relating to fundamental changes to the activities of an investee or applying in exceptional circumstances.

Apparently, substantive rights are rights that are not protective rights. Paragraphs B22-B25 of AASB 10 describe various features or types of substantive rights, such as:

- for a right to be substantive, the holder must have the practical ability to exercise that right (paragraph B22);
- substantive rights are exercisable when decisions about the direction of the relevant activities need to be made (whether or not the rights are currently exercisable) (paragraph B24); and

- substantive rights do not require the holder to have the ability to initiate decisions: they might give the holder only the current ability to approve or block decisions that relate to the relevant activities of an investee (paragraph B25).

Classifications in the Draft Guidance Queried by Board Members

The table below lists the classification of rights in the pre-ballot draft of the implementation guidance that were queried by one or both of the two Board members, including those from the Local Government example noted above. Staff comments are added.

Para ref	Rights and Classification	Staff Comments
IG13	Government power to appoint/remove majority of members of a governing body – Substantive	Substantive in sense of rights that the holder has the practical ability to exercise. Strengthen by adding “without cause” so that the power is not conditional at all.
IG16	Regulatory powers that give regulator ability to direct the relevant activities of an investee in particular circumstances – Substantive	Not protective rights, as they give the ability to direct the relevant activities contingent on circumstances (see para B53 of AASB 10).
IG17(e)	Trust’s power to determine where charity’s net assets distributed on liquidation – Substantive	Relevant activities of the charity change when it is being liquidated, and the trust has substantive rights then.
Example IG2C	Right of charity to veto appointments to board of investee in exceptional circumstances – Protective	Not substantive rights, as apply only by exception. (If the veto is substantive, then the conclusion in Ex IG2C would change. Would then amend Ex IG2D to ensure no board control by the charity, to retain that example.)
Example IG3	State Government rights to restructure boundaries of a local government or to abolish the Council – Protective	Protective as in reality the rights could be exercised only in exceptional circumstances. Alternatively, could avoid classification altogether by arguing that these rights are not related to any relevant activities of the local government.
Example IG3	State Government rights to approve/veto Council entering entrepreneurial endeavour exceeding 5% of rates – Substantive	Entrepreneurial activities may be an important part of the local government’s relevant activities, providing goods or services to ratepayers and others.
Example IG3	State Government rights to approve/veto Council investment in new types of financial instruments – Substantive	Investment is a regular activity, however a new type of investment might be exceptional. Change to protective right.
Example IG3	State Government rights to make guidelines concerning the Council’s procurement policy or the provision of services – Substantive	Guidelines either direct or frame the specific policies of the Council – if direct, then substantive; if frame, then protective. Simpler to change to protective rights, rather than justify “guidelines” as substantive with more detail as to their content and status.

Judgement clearly is required to distinguish substantive and protective rights in many cases. As with any judgement, there may be different views.

Question for the Board

- Q2 Do members agree with the two reclassifications suggested by staff in the table above (see the last two rows) and otherwise that rights have been appropriately classified as substantive or protective in the draft implementation guidance?