

Issues paper: The future of the AASB/FRSB project

Introduction

1. Agenda paper B12.3 'Identification of Issues Associated with the Application of Control' reflects the work undertaken to date on the Boards' project 'Defining the Reporting Entity in the Public Sector (including consideration of the concept of control)'. The paper was prepared in accordance with the project outline previously agreed by the Boards. However, in seeking comments on an earlier draft of the paper from the joint sub-committee, some sub-committee members questioned the merits of continuing with the long-term, broadly-scoped, conceptually-dependent project, particularly in light of the imminent release by the IASB of a revised definition of 'control'. The types of comments made by some sub-committee members are noted in Appendix A of this paper.
2. The purpose of this paper is to facilitate the Boards' discussion of 'where to from here'. In particular, the paper:
 - (a) explores alternative processes for addressing the public sector issues that might arise from the imminent revised IASB definition of control in light of the AASB/FRSB project; and
 - (b) considers issues relevant to the scope of the AASB/FRSB project.

Background

3. The existing definition of control in paragraph 4 of IAS 27 is:

Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.
4. Both Australia and NZ currently adopt this definition unamended in their respective domestic standards and provide additional, albeit different, accompanying material to explain the public sector specific context.
5. The IASB is scheduled to issue a replacement of IAS 27¹ in Q4 2010 (we expect in December). To this end, an IASB staff draft² IFRS X *Consolidated Financial*

1 The new IFRS will only address matters relating to consolidated financial statements. IAS 27 will be renamed and restructured to deal only with separate financial statements. IASB also plans to issue a further Exposure Draft about 'investment companies', which is expected to propose non-consolidation of controlled entities.

2 The IASB staff draft does not include disclosure requirements. Disclosures will be the subject of a separate IFRS, covering the disclosures for involvement with subsidiaries, joint arrangements, associates and unconsolidated structured entities, expected to be issued in Q4 2010.

Statements has been released (see Agenda paper B12.4, provided for your information). Appendix A of the staff draft contains the following definition of control:³

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 power⁴ over the **investee**.

6. Given the likelihood of the replacement definition including private sector oriented terminology such as ‘investor’, ‘investee’ and ‘variable returns’, there will be a need for the AASB and FRSB to consider public sector implications of such a definition.
7. However, Phase 2 of the AASB/FRSB project (see Appendix 2 of agenda paper B12.3), which would consider any new IASB definition of control, is not scheduled to be undertaken until after the expected issue date of the replacement standard, although it is scheduled to be finalised before the IASB replacement standard becomes mandatory. We are aware from IPSASB staff that a review of IPSAS 6 *Consolidated and Separate Financial Statements* forms part of the IPSASB Business Combinations project but this review is unlikely to happen in the near future. We have not yet finalised our review of the IASB staff draft. Despite this, we are seeking initial soundings from the Boards as to how we should proceed.

Possible ways to proceed

8. A question is how best to deal with the imminent issue of the IASB replacement standard. On the assumption that the AASB/FRSB project is intended to be a longer-term project looking at fundamental aspects of control⁵ that will not be finalised by Q4 2010, alternatives for dealing with the replacement standard being issued in Q4 2010 include:
 - (a) retain the current approach to control in the public sector as an interim position until the longer-term project has thoroughly reviewed the issues. There is precedent for this, for example in relation to borrowing costs, (whereby both

3 In contrast, the definition of ‘control of an entity’ in IASB ED 10 is “The power of a reporting entity to direct the activities of another entity to generate returns for the reporting entity.”

4 The IASB staff draft defines ‘power’ as “The current ability to direct the relevant activities.”

5 We acknowledge that some sub-committee members have questioned whether it continues to be appropriate to undertake the longer-term work looking at fundamental aspects of control – see Appendix A of this paper. We discuss this further in paragraph 11 below.

AASB and FRSB retained the option to expense until further work is undertaken); and the AASB did not allow early adoption of AASB 3 *Business Combinations* (March 2008) by not-for-profit entities pending further work on the implications for not-for-profit entities. This approach would enable project resources to continue to focus on longer-term solutions; or

- (b) initiate a fast-track short-term project to develop interim Aus/NZ public sector paragraphs for inclusion in the replacement standard ready for, or at least shortly after, its issue date; continue with the longer-term project as planned; and amend the replacement standard again once that work is complete. The interim domestic public sector paragraphs could be informed by the work done to date in the AASB/FRSB project. This approach would drain resources from the longer-term work and could mean potentially changing requirements in relatively quick succession. The question would also arise as to whether there would be a need to expose the Aus/NZ paragraphs for comment – and the length of the exposure period. Although Australian constituents were asked to comment on IASB ED 10 *Consolidated Financial Statements* from a public sector perspective⁶, constituents have not yet had an opportunity to consider how the Boards might deal with those comments. Accordingly, if the Boards⁷ decide that a further exposure process is warranted, it is unlikely that the Boards could finalise their technical decisions by the time the IASB issues its replacement standard.

9. From a NZ perspective, any proposed modifications for public benefit entities would need to be issued for comment in accordance with the due process requirements in ASRB Release 8 *The Role of the Accounting Standards Board and the Nature of Approved Financial Reporting Standards*. In addition, the NZ Request for Comment

⁶ In particular, AASB ED 171 *Consolidated Financial Statements* (issued December 2008), which incorporated the IASB's ED 10, included a specific matter for comment: 'To assist with its ongoing research as part of the AASB's separate longer-term project on control in the public sector, the AASB would value comments on the suitability of the IASB's proposals in a not-for-profit public sector context if some or all of the proposals were to be adopted'. We received seven submissions, of which three commented from a public sector perspective – all of which expressed a view questioning the suitability of the word 'return' in the definition of control applicable to not-for-profit entities. Some made suggestions on how to address this by, for example, suggesting explicit reference to 'achieving the objectives of the controlling entity'.

⁷ We have assumed that the Boards would want to work jointly on this issue. However, given the uncertainties about the financial reporting framework in NZ, it might be that the Boards decide to proceed separately and in different directions.

that accompanied ED 10 specifically stated that feedback would be sought from constituents on any NZ modifications made to the ED and constituents' comments would be considered in finalising the standard.

10. From an Australian/NZ convergence perspective, it is also relevant to note that there is still uncertainty about the future of the NZ financial reporting framework, including whether public sector and not-for-profit entities would be required to comply with IPSASs rather than modified IFRSs.
11. Irrespective of the approach the Boards adopt for dealing with the IASB replacement standard (whether one of the approaches identified in paragraph 8 above or another approach), the question still remains as to what the scope of the longer-term project should be, and indeed whether there would be an ongoing need for a longer-term project. Some sub-committee members have suggested that the scope of the project should be limited to 'control of entity' issues (and therefore scope out 'control of assets' [ie control vs administered] issues). Others go on to argue that the scope of the project should be further narrowed by identifying a limited number of pressing 'control of entity' issues and focusing attention on those, accepting conceptual issues as 'givens', with a view to making incremental improvements in guidance and application. Agenda paper B12.3 has usefully identified some of these – particularly in section 5.0 'Interpretation Issues Relating to the Definition of Control of an Entity'.
12. ***Project team view:*** In relation to dealing with the imminent release of the IASB replacement standard, on balance, the project team prefers approach (a) as described in paragraph 8 above – maintaining the status quo for the public sector until the issues can be dealt with thoroughly through the Boards' joint project, the objective being to resolve public sector issues before the IASB replacement standard becomes mandatory. In the longer-term, we think there would be benefit in continuing to pursue the broadly-scoped, conceptually-dependent project in accordance with the project plan, noting that it can be pursued contemporaneously with the IASB and IPSASB conceptual framework projects. We think such a project not only has the potential to make a substantial contribution to public sector financial reporting in Australia and NZ, but we think it could also contribute to the work of the IPSASB.

APPENDIX A

Comments by some sub-committee members⁸ questioning the merits of a long-term, broadly-scoped, conceptually-dependent project

1. As a joint AASB/FRSB project, the project should not focus on defining the reporting entity in the public sector, given the different ways in which New Zealand and Australia perceive the reporting entity concept. Rather, the project should focus on the concept of entity control within the public sector. This would have implications for the title of the project.
2. Dealing with control of assets, and therefore administrative items, is too broad.
3. The focus of the Boards needs to be on:
 - (a) the new IASB standard on consolidations and its appropriateness for the public sector; and
 - (b) dealing with any easily fixable interpretation/guidance issues with the current AASB 127/NZ IASB 27 – but acknowledging the cost benefit of doing this given the remaining time frame of the existence of this standard vis-à-vis the IASB's imminent release of a replacement Consolidations standard.
4. It is difficult to see how the issue of 'control in the public sector' can be dealt with adequately if the Boards are not prepared to open up the conceptual issues for debate. This project needs to be either very broad (and therefore conceptual and long-term in nature) or very narrow (taking most issues as 'givens' and making incremental improvements in guidance and application). Unless we keep this project very narrow and focused, there is unlikely to be progress.
5. There is a strong case for a level of pragmatism here to resolve the more pressing issues or where we have inconsistent treatments. We need to acknowledge that this is a journey but improvements in financial reporting can be made by directly addressing a limited number of current issues.

⁸ These comments have been paraphrased.