



ITC 17 sub 1

New South Wales  
TREASURY

Professor David Boymal  
The Chairman  
Australian Accounting Standards Board  
PO Box 204  
COLLINS ST WEST VIC 8007

Contact: Barbara Richardson  
Telephone: (02) 9228 4832  
Our Reference: T06/01080  
Your Reference: ITC 17

19 August 2008

Dear Professor Boymal

**Comments on ITC 17 – The Reporting Entity**

NSW Treasury welcomes the opportunity to provide comments to the Australian Accounting Standards Board's Invitation to Comment 17 Request for Comment on IASB Discussion Paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity*.

To summarise our views on the discussion paper, NSW Treasury:

- strongly urges the AASB to recommend that the IASB consider all entities concurrently and does not support an initial focus restricted to business entities in the private sector
- believes that 'reporting entity' should be defined rather than broadly described and
- believes that a definition of 'reporting entity' should refer to:
  - 'users' in general rather than the narrower term 'capital providers' and
  - 'objectives' rather than 'benefits'.

In addition, we strongly support continuance of the reporting entity principle as the basis for differential reporting in Australia.

NSW Treasury's detailed comments on the above discussion paper are attached.

If you have any queries regarding these comments, please contact me on (02) 9228 3019 or Barbara Richardson on (02) 9228 4832.

Yours sincerely

Robert Williams  
for Secretary

### **General Comments in response to AASB Specific Matters for Comment:**

- (a) The IASB Discussion Paper discusses the role of the reporting entity as a concept guiding the determination of the boundaries of the entity to be reported on, not its role as the basis for differential reporting. This will be reflected in NSW Treasury's response to the IASB. However, we note that the AASB Preface to ITC 17 says at page vii that the AASB has tentatively decided to change the focus of the application of Australian Accounting Standards from 'reporting entity' to 'general purpose financial statements'. NSW Treasury considers that the reporting entity concept is fundamental to financial reporting because it ensures financial statements are prepared whenever users can be identified. We therefore support continuance of the reporting entity principle as the basis for differential reporting.

NSW Treasury disagrees with the initial focus on business entities in private sector. The IASB needs to consider all types of entities concurrently. Most, if not all, of the issues discussed are equally relevant to for-profit and not-for-profit entities. Considering all types of entities concurrently should avoid any future inconsistencies in treatment.

- (b) The proposals in the discussion paper have limited scope as the focus is for-profit entities only and the users are restricted to capital providers.
- (c) No comment.

### **IASB List of questions for respondents**

#### **Section 1: The reporting entity concept**

**Question 1: Do you agree that what constitutes a reporting entity should not be limited to business activities that are structured as legal entities: If not, why?**

Agree.

**Question 2: Do you agree that the conceptual framework should broadly describe (rather than precisely define) a reporting entity as a circumscribed area of business activity of interest to present and potential equity investors, lenders and other capital providers? If not, why? For example, do you believe that the conceptual framework should establish a precise definition of a reporting entity? If so, how would you define the term? Do you disagree with including reference to equity investors, lenders and other capital providers in the description (or definition) of a reporting entity? If so, why?**

Disagree.

1. There should be a definition – the 'reporting entity' is too important a concept to merely describe. The 'reporting entity' is a key concept, along with 'control', the 'objective of financial reporting' and 'general purpose financial report.' Given that the IASB and AASB will no longer have a role in determining which entities produce general purpose financial reports, it is important that the standard setters have clear guidance about the types of entities that are likely to be reporting entities that should produce general purpose financial reports. We do not agree that being too prescriptive would result in a failure to meet the objective of financial reporting (paragraph 13).
2. We believe the definition in Australian Statement of Accounting Concepts (SAC) 1 is a good starting point: an entity (including an economic entity) in respect of which it is

reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources (SAC 1.40).

The phrase ‘circumscribed area of business activity’ is too vague. For example, a segment could be interpreted as a ‘circumscribed area of business activity’ and this could lead to the incorrect assumption that a segment is a reporting entity. There should be an explicit link in the definition between ‘reporting entity’ and ‘objective of financial reporting’. As currently exists, there should be separate definitions for ‘entity’ and ‘economic entity’ (or group reporting entity) and an explicit link with ‘control’ in the definition.

We prefer the current AASB approach where the definition of an entity is linked to ‘having the capacity to deploy scarce resources in order to achieve objectives’. The reason for not considering this further (paragraph 13) could be easily addressed and not including this concept could result in a bigger issue (or at least an issue of equal concern) that bodies that are ‘parts’ of an entity and are not able to deploy resources are treated as separate reporting entities. Or that a reporting entity may be too broad and might include arrangements over which there is no capacity to deploy resources. This is also linked with the concept of control; i.e. the phrase ‘capacity to deploy scarce resources’ provides a good link to the definition of ‘control.’

Also consistent with the AASB approach, the definition of an economic entity could include the concept of ‘operating together to achieve objectives consistent with those of the controlling entity.’ The equivalent in the IASB proposal is the phrase ‘access benefits’, which seems narrower and does not draw in the concept of ‘operating together...’.

The above ensures more clear linkages between key definitions – otherwise, no concept of control is included in the definition of reporting entity. In summary, NSW Treasury suggests the definition of ‘reporting entity’ should include the term ‘entity’ rather than ‘circumscribed area of business activity’ and separate definitions of ‘entity’ and ‘economic entity’, which feed back into the definition of ‘control’. This provides a linkage between all key definitions that is more transparent.

3. We disagree with including a reference to equity investors, lenders and other capital providers – it’s too narrow. See SAC 1 definition above for suggested wording. The term ‘users’ (rather than ‘capital providers’) can be relevant to both for-profit and not-for-profit entities.

In the future, the needs of other users (that are not capital providers) are likely to become increasingly important, in both the public and private sectors, with the widening perspective of corporate responsibility. The use of a generic term is also a more robust approach that will more readily accommodate not-for-profit entities, but which is equally relevant to for-profit entities.

## Section 2: Group reporting entity

**Question 3: Do you agree that the risks and rewards model does not provide a conceptually robust basis for determining the composition of a group reporting entity and that, except to the extent that it overlaps with the controlling entity model (as discussed in paragraphs 102 and 103), the risk and rewards model should not be considered further in the reporting entity phase of the conceptual framework project? If not, why?**

We agree that, on its own, the risks and rewards model does not provide a conceptually robust basis for determining the composition of a group reporting entity. However, if the definition of control under the controlling entity model refers to both power and benefits, a risks and rewards approach is implied. It not only overlaps with the controlling entity model, it forms part of it. There is no reason to abandon it simply because, to date, its use has been predominantly restricted to special purpose entities. Australian Interpretation 112 *Consolidation – Special Purpose Entities* provides indicators and guidance on control of an SPE which would be equally applicable to other entities. Refer Consensus paragraph 10(a)-(d) of Interpretation 112.

Although referring to control of assets rather than entities, AASB 117 *Leases* refers to a risks and rewards approach to determine control. IPSASB in its Consultation Paper issued in March 2008 on Accounting and Financial Reporting for Service Concession Arrangements (SCA) suggests that both the concepts of control and risks and rewards should be considered in determining how grantors should report property associated with an SCA. NSW Treasury also does not see any reason to ignore the definition of control of an asset when considering a definition for control of an entity because these concepts are interrelated. For example, in Australia the definition of an entity refers to ‘capacity to deploy scarce resources in order to achieve objectives’. In effect, this means that for control of an entity to exist, there must be the power to require an entity’s assets to be deployed towards achieving objectives (AASB 127Aus17.8). Because of this interrelationship, it may be beneficial to consider the two concepts in tandem, for consistency. It would not be desirable for these two concepts to be inconsistent.

NSW Treasury believes that ensuring the risks and rewards model is incorporated into the controlling entity model would provide a conceptually robust basis for determining the composition of a group reporting entity. Risks and rewards, as a subset of the controlling entity model, should be further explored in this phase of the conceptual framework project.

**Question 4: Assuming that control is used as the basis for determining the composition of a group reporting entity, do you agree that:**

- (a) control should be defined at the conceptual level?
- (b) The definition of control should refer to both power and benefits?

**If not, why? For example, do you have an alternative proposed definition of control?**

NSW Treasury agrees that control should be defined at the conceptual level and the definition should refer to power (or capacity to dominate).

Comments regarding the IASB’s working definition of control:

We are not comfortable with the term ‘access benefits’. We prefer the current AASB wording in SAC 1; i.e. ‘achieving the objectives’. There may be a connotation that the term ‘benefits’ refers to only financial or cash flow benefits, whereas, for not-for-profit entities, ‘achieving objectives’ is a broader term that includes service delivery objectives. Notwithstanding that the term ‘achieving the objectives’ is more appropriate for not-for-profit entities than ‘accessing benefits’, it is equally appropriate in the private sector. As is currently the case, the term ‘achieving the objectives’ should flow through to the definitions of entity and economic entity to provide linkage.

Regarding the term ‘ability to direct’, we suggest considering the SAC 1 term ‘capacity to dominate decision-making, directly or indirectly...’, particularly in relation to capturing

special purpose entities; i.e. indirectly dominates by establishing a structure which then operates on auto-pilot, such that the entity has delegated those decision-making powers.

We also are not certain that the last phrase in the working definition adds anything:

“and increase, maintain or protect the amount of those benefits (or reduce the amount of those losses).”

As for an alternative proposed definition of control, we suggest retaining the current definition in SAC 1:

“**control**” means the capacity of an entity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of another entity so as to enable that other entity to operate with it in achieving the objectives of the controlling entity.

**Question 5: Do you agree that the composition of a group reporting entity should be based on control? If not, why? For example, if you consider that another basis should be used, which basis do you propose and why?**

Yes.

**Question 6: Assuming that control is used as the basis for determining the composition of a group reporting entity, do you agree that the controlling entity model should be used as the primary basis for determining the composition of a group reporting entity? If not, why?**

Yes. However, we do not see a problem with including the risks and rewards concept within the controlling entity model. We would like to see one control model applicable to all types of entities.

**Question 7: Do you agree that the common control model should be used in some circumstances only? If not, why? For example, would you limit the composition of a group reporting entity to the controlling entity model only? Or would you widen the use of the common control model? If you support the use of the common control model, at least in some circumstances, do you regard it as an exception to (or substitute for) the controlling entity model in those circumstances, or is it a distinct approach in its own right? Please provide reasons for your responses.**

We agree in principle that the controlling entity model should be the primary basis for determining the group reporting entity. The common control model may sometimes be relevant in the public sector context when there is no identifiable parent entity; e.g. the general government sector or at the whole-of-government level. The common control model should be an exception to, not a substitute for, the controlling entity model.

### **Section 3: Parent entity financial reporting**

**Question 8: Do you agree that consolidated financial statements should be presented from the perspective of the group reporting entity, not from the perspective of the parent company’s shareholders? If not, why?**

NSW Treasury agrees that consolidated financial statements should be presented from the economic entity's viewpoint. However, we do not believe that the entity perspective versus the proprietary perspective has been adequately discussed or debated to justify this conclusion.

**Question 9: Do you agree that consolidated financial statements provide useful information to equity investors, lenders and other capital providers? If not, why?**

We agree. However, the useful information provided is not limited to capital providers. Many other groups would also find the information useful. For this reason, we do not support a definition referring to 'capital providers'. The term 'users' (rather than 'capital providers') can be relevant to both for-profit and not-for-profit entities.

In the future, the needs of other users (that are not capital providers) are likely to become increasingly important, in both the public and private sectors, with the widening perspective of corporate responsibility. The use of a generic term is also a more robust approach that will more readily accommodate not-for-profit entities, but which is equally relevant to for-profit entities.

**Question 10: Do you agree that the conceptual framework should not preclude the presentation of parent-only financial statements, provided that they are included in the same financial report as consolidated financial statements? If not, why?**

We agree. Both sets of financial statements provide useful information.

**Section 4: Control Issues**

**Question 11: With regard to the concept of control, in the context of one entity having control over another, do you agree that**

- a) **establishing whether control exists involves assessing all the existing facts and circumstances and, therefore, that there are no single facts or circumstances that evidence that one entity has control over another entity in all cases, nor should any particular fact or circumstances—such as ownership of a majority voting interest—be a necessary condition for control to exist? If not, why?**
- b) **the concept of control should include situations in which control exists but might be temporary? If not, why?**
- c) **the control concept should not be limited to circumstances in which the entity has sufficient voting rights or other legal rights to direct the financing and operating policies of another entity, but rather should be a broad concept that encompasses economically similar circumstances? If not, why?**
- d) **in the absence of other facts and circumstances, the fact that an entity holds enough options over voting rights that, if and when exercised, would place it in control over another entity is not sufficient, in itself, to establish that the entity currently controls that other entity? If not, why?**
- e) **to satisfy the power element of the definition of control, power must be held by one entity only? In other words, do you agree that the power element is not satisfied if an entity must obtain the agreement of others to direct the financing and operating policies of another entity? If not, why?**

- (f) that having 'significant influence' over another entity's financing and operating policy decisions is not sufficient to establish the existence of control of that other entity? If not, why?

We agree with all of the above.

**Question 12: Should any of the above control issues be addressed at the standards level rather than at the concepts level? If so, which issues and why?**

The above control issues are at a sufficiently high level to be addressed in the Framework. However they may need to be elaborated, if not already done so, at the standards level; e.g. AASB 127 *Consolidated and Separate Financial Statements*.

**Question 13: Are there any other conceptual issues, relating either to the control concept or to some other aspect of the reporting entity concept, that are not addressed in this discussion paper and should be addressed at the concepts level? If so, which issues and why?**

Other public sector issues regarding control (refer the Australian paragraphs in AASB 127 *Consolidated and Separate Financial Statements*) not addressed include:

- the fact that power to regulate does not of itself equate to control (AASB 127.Aus17.9(d))
- the role of accountability in understanding control (AASB 127.Aus17.2(a))
- when the government has the residual financial interest in the net assets of the other entity (AASB 127.Aus17.2(b))
- Ministerial approval / control / directions (AASB 127.Aus17.3(a))
- the role of legislation; i.e. when the mandate of an entity is established / limited by enabling legislation (AASB 127.Aus17.3(f))
- the controlling entity's ability to deploy scarce resources to achieve objectives; specification of separate objectives (AASB 127.Aus.17.7-8)
- the fact that financial dependency is not control (AASB 127.Aus17.9(c)) and
- control versus day-to-day management (AASB 127.Aus17.10).