

Dr Keith Kendall
The Chair
Australian Accounting Standards Board
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Dear Dr Kendall

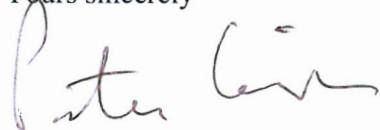
***ITC 51 – Post-implementation Review of Not-for-Profit Topics –
Control, Structured Entities, Related Party Disclosures and Basis of
Preparation of Special Purpose Financial Statements***

The Heads of Treasury Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to provide comments to the Australian Accounting Standards Board (AASB) on the Invitation to Comment (ITC) 51 *Post-implementation Review of Not for Profit Topics – Control, Structured Entities, Related Party Disclosures and Basis of Preparation of Special Purpose Financial Statements*.

While HoTARAC considers the current guidance useful, particularly the illustrative examples, HoTARAC notes that application of these requirements often requires significant judgements from preparers. Accordingly, we have suggested additional guidance and examples in the attachment on the matters for comment to promote consistency of accounting treatment and relevance to users.

If you have any queries regarding HoTARAC's comments, please contact Peter Gibson from the Australian Government Department of Finance on (02) 6215 3551 or via email at Peter.Gibson@finance.gov.au.

Yours sincerely



Peter Gibson
Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC)
27 March 2023

ATTACHMENT

Matters for Comment Post-implementation Review of Not-for Profit Topics – Control, Structured Entities, Related Party Disclosures and Basis of Preparation of Special Purpose Financial Statements

ITC 51 REQUEST FOR COMMENTS

Topic 1: Control and consolidation for NFP entities

Questions for respondents

Application of the control model in the NFP sector

Regarding AASB 10 Appendix E, do you have any comments about:

1. the outcomes of applying the control model and Appendix E in practice in the NFP sector?

Application of AASB 10 to not-for-profit entities often requires the exercise of greater judgement than for the private sector. Appendix E is helpful in this regard, but differences in practice may still emerge, particularly in respect of distinguishing protective and substantive rights and the extent of investor's exposure to variable non-financial returns.

2. difficulties that might be experienced in identifying and consolidating controlled entities, including difficulties accessing necessary information?

HoTARAC members sometimes encounter difficulties in identifying all their controlled entities, especially for those having a broad range of responsibilities. These entities are more likely to have power over other entities' activities and have overlapping policy objectives.

3. whether differences in application exist in practice in applying the control model and Appendix E in the NFP sector? If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.

HoTARAC notes that applying AASB 10 control assessments in the NFP public sector will often require significant judgement and may result in inconsistent application. Examples include paragraph IG7 noting that research and development corporations may not be controlled by government even though the government establishes the corporations' legislative mandate, whereas IG10 notes that organisations supporting independent statutory office holders may still be assessed as government controlled because the government issues the legislative framework that governs the office holders' operations.

Another example is identifying barriers to an investor's practicable ability to exercise their rights. Paragraph IG13 says "For some not-for-profit investors, political, cultural, social or similar types of barriers might make it difficult for the investor to exercise rights held in relation

to an investee. However, the investor's rights would be substantive, despite such barriers, if the investor can still choose to exercise those rights." In practice, more factors interplay so that it is challenging to determine whether it is an investor's "choice" to not exercise their power.

For example, an individual/entity is given certain power under enabling legislation but in the past the power was never exercised. Often, the information about why the individual/entity was given the power and under what circumstances the power was expected to be exercised is also lost over time. Another example is when an individual/entity is given certain power to intervene without constraints under enabling legislation, but many other entities also carry out their responsibilities under the same legislation and that individual/entity may never have a good reason to exercise the power even though legally they don't need a reason to intervene.

It's not clear whether the substantive power exists under such circumstances and different interpretation could arise.

In the public sector, profit is generally not the main objective and the relevant activities are shared objectives. In some structures, there are often multiple parties, each with different policy objectives. This can result in different parties exposed to different returns in terms of both financial and policy objectives. This makes it difficult to identify the relevant activities; identify which parties are exposed or have most exposure to returns from those relevant activities and whose rights are substantive or protective.

HoTARAC acknowledges the examples of Appendix E are very helpful in applying the standard.

4. In addition to the existing guidance in AASB 10 Appendix E, is there any other guidance that would help with applying the control model in the NFP sector? If so, please provide details of the guidance and explain why you think it would be useful.

Overall, HoTARAC considers AASB 10 Appendix E has significantly assisted in the assessment of control within the NFP public sector. The implementation examples in Appendix E, such as IG3 and IG4 on control assessments for local governments and universities respectively, are particularly helpful.

Identifying variable returns in the NFP sector

5. Do you have any comments about difficulties that might be experienced in identifying variable returns in the NFP sector? If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.

The variable returns criteria is often met as a default conclusion, especially for public sector entities that have a wide range of service objectives. More generally in the not-for-profit sector, service objectives of different entities are often related or overlapping. It may be useful to clarify the extent to which the threshold of exposure to variable returns is needed for control over an investee to exist in the NFP context.

6. In addition to the existing guidance in AASB 10 Appendix E, is there any other guidance that would help with identifying variable returns in the NFP sector? If so, please provide details of the guidance and explain why you think it would be useful.

HoTARAC considers that paragraphs IG18-19, IG22 and the implementation examples in Appendix E of AASB 10 are useful.

Customary business practices in the NFP sector

7. Do you have any comments regarding customary business practices in the NFP sector? If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.

HoTARAC agrees that customary business practice may be a relevant consideration in assessing whether the control criteria are met. Existing guidance in paragraph IG13 is useful.

We note the term ‘customary business practices’ is not used in AASB 10. To the extent this concept is added to AASB 10, we would assume it should be relevant to all three limbs of paragraph 7 and not just variable returns.

The challenge in the NFP context is that customary business practices are often the result of a combination of interplaying factors. For example, there is no binding obligation to distribute profits to a particular entity, but in practice, the recipient entity has been relying on it as the key revenue source for a long time and the continuing operation of the entity is critical to many stakeholders. Therefore, relevant stakeholders may intervene if there is a change in profit distribution pattern. If customary business practices is added to AASB 10, the practical ability of the parties to change those practices should be considered in assessing whether the customary business practices equate to rights and obligations.

Assessing control without an equity interest

Regarding assessing control without an equity interest, do you have any comments about:
8. the application of the requirements in practice?

No comment.

9. whether differences in application exist in practice? If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.

HoTARAC is not aware of any differences in application in practice on this issue.

10. In addition to the existing guidance in AASB 10 Appendix E, is there any guidance that would help with assessing control without an equity interest? If so, please provide details of the guidance and explain why you think it would be useful.

HoTARAC considers that existing guidance in AASB 10, including paragraphs 11, B6, IG6-IG7 and IG18-IG19 is useful. HoTARAC has no suggestions for additional guidance aside from those identified in other responses.

Principal v agent – public sector entities

Regarding assessing whether an NFP entity in the public sector is acting as principal or an agent do you have any comments about

11. distinguishing the role of an entity in practice?

12. whether differences in application exist in practice when applying the control model and Appendix E? If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.

Distinguishing whether an entity is agent or principal is frequently challenging for not-for-profit entities for the following reasons:

- Roles of various parties are often prescribed in legislation or regulation, making it difficult to determine whether one entity (a principal) delegated its decision-making powers to another entity (an agent).
- The lack of financial returns makes it difficult to quantify the returns and the variability of returns of each party.

As noted in other responses, often several parties will be exposed to returns that contribute to their separate policy objectives.

13. In addition to the existing guidance in AASB 10 Appendix E, is there any guidance that would help you determine whether an NFP entity is a principal or an agent? If so, please provide details of the guidance and explain why you think it would be useful.

HoTARAC considers that existing guidance in AASB 10, including paragraphs 17-18, B58-75, IG21-IG24 and application examples are adequate. Distinguishing between principal and agent in accounting can be complex, so we note that other types of not-for-profit entities may consider additional guidance to be useful.

Topic 2: The definition of a structured entity for NFP entities

Questions for respondents

Regarding the definition of a structured entity in the NFP sector and the guidance in Appendix E, do you have any comments about:

14. the application of the requirements in practice?

15. any other matters of which the AASB should be aware as it undertakes this PIR?

If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.

The scope of structured entities in the NFP public sector is often unclear in practice. Guidance in AASB 12(IG5) which “limits the scope of structured entities to entities that are controlled through less conventional means” could be contextualised /explained in the public sector context. Application examples to illustrate typical scenarios of where entities meet or do not meet the AASB 12 criteria as structured entities would be helpful.

For example, a government establishes an entity responsible for helping to find loans at reasonable costs for companies in financial distress. The entity only receives initial start up funding for its operation in year one and is responsible for its own operational outcomes going forward; besides, it has full discretion over the eligibility of its customers (i.e. companies in distress) and suppliers (financial institutions providing loans). Is the entity controlled by the government because it is set up by the government to fulfil an objective (policy) for the government, even though the government does not have substantive power to direct its activities? Some guidance will be helpful to clarify whether such scenarios are intended to be captured either by AASB 10 or AASB 12.

Topic 3: Related party disclosures by NFP public sector entities

Question for respondents

16. Do you have any comments regarding the disclosure of related party information by NFP public sector entities? If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.

It is occasionally difficult to establish who are the key management personnel of a NFP public sector entity. This occurs because the organisation structure of some entities are not similar to those in for profit entities on which AASB 124 is predicated. For example, courts and the military services have two parallel management structures, where the “administrative” structure is different from the structure of the judges or military officers, but where both structures have roles in the financial and operating policies of the entity, resulting in extensive KMP disclosures. Another example is where there is a statutory office holder who is legally independent of the organisation established to carry out their functions. Having a large number of KMP can result in difficulties in ensuring completeness of representations made by KMP and in assessing the materiality of related party transactions.

In HoTARAC's view the requirements to disclose transactions with other entities in the same government (paragraphs 25-27) could be refined. Some types of these transactions are routine in nature, such as appropriations and transactions with bodies established for central administration of activities such as the use of property, management of long service leave, procurement and shared services. In our view the objectives of AASB 124.1 do not justify disclosure in all instances, as these transactions are usually within the normal course of business. Similarly, if assets are transferred between agencies, even outside the normal course of business, details of those transactions would ordinarily already be disclosed elsewhere if material, for example, in accordance with AASB 1004.58. There shouldn't be a need to provide additional KMP disclosures.

Paragraph IG11 notes that public services provided on the same terms as available to the public, may not be material. Appendix A of Practice Statement 2 *Making Materiality Judgements* includes guidance on the materiality of operational transactions with key management personnel on normal terms and conditions. The AASB could consider incorporating the public sector related party material from the Practice Statement into the implementation guidance of AASB 124 to ensure consistency in practice.

Further, while Practice Statement 2 is useful in complying with the provisions of AASB 124, it would benefit from additional guidance about determining materiality by nature. HoTARAC also notes that practical challenges arise with application. These include:

- a) Calculating the superannuation component of remuneration, when KMP are members of a defined-benefit fund of the type more prevalent in the public sector;
- b) Disclosure of the leave component of remuneration. Remuneration calculations typically include the movements in leave provisions, which may be negative if the provision is "run down", or if there is a significant increase in discount rates. Negative amounts in a remuneration calculation are counter-intuitive and difficult for users to understand;
- c) Difficulty in identifying a complete list of related parties and collecting information where there is no legal power to compel the information be provided; and practical audit issues, as set out in the response to question 19 below;
- d) Difficulty in reconciling accrual-based remuneration information required by AASB 124 with cash-based remuneration levels set by independent regulators such as the Commonwealth Remuneration Tribunal.

Some of these issues are not unique to the NFP public sector but are often magnified because of the nature of related parties and users.

Topic 4: Basis of preparation of special purpose financial statements – disclosures about compliance with Australian Accounting Standards**Question for respondents**

17. Do you have any comments regarding the SPFS disclosures regarding compliance with Australian Accounting Standards by NFP private sector entities? If so, please provide your views on those requirements, relevant circumstances and their significance. Examples to illustrate your responses are also most helpful.

No comments.

AASB General Matters for Comment

In addition to the specific matters for comment on each topic, the AASB would also particularly value comments on the following:

18. Does the application of the requirements considered in this ITC adversely affect any regulatory requirements for NFP entities?

In the Commonwealth, the existence of some types of related party transactions may have legal consequences:

- For ministers and other members of parliament, they may be disqualified under Section 44 of the Constitution.
- For related parties who are also members of the Australian Public Service, they may contravene Part 3 of the Public Service Act 1999.

19. Does the application of the requirements considered in this ITC result in major audit or assurance challenges?

HoTARAC notes that the extent of judgement applied in application can create challenges for auditors. We suggest that the AASB engage further with audit providers about this issue.

Our observation is that auditors in the public sector have challenges in respect of related party disclosures other than KMP remuneration, in part caused by the different nature of related parties in the public sector. We understand that this extends to difficulty in obtaining sufficient evidence that all related parties have been identified and that information provided is complete and accurate.

20. Overall, do the requirements considered in this ITC result in financial statements that are more useful to users of NFP entity financial statements?

No comment from preparer perspective.

21. In your view, do the benefits of applying the requirements considered in this ITC exceed the implementation and ongoing application costs for NFP entities?

HoTARAC's view is that the benefits of disclosure of KMP remuneration in the public sector exceed the costs of applying the requirement of the standard.

However, our view is that the costs of applying other related party disclosures in our members' jurisdictions exceed the benefits for NFP entities. Very few disclosures have been made, and in respect of ministers the process mostly overlaps with existing parliamentary public disclosure requirements.

22. Are there any other matters that should be brought to the attention of the AASB as it undertakes this PIR.

No comments.