



**Audit & Risk Advisory Services**  
147 Collins Street  
Melbourne Vic 3000

GPO Box 2291U  
Melbourne Vic 3001  
Australia

ABN: 51 194 660 183  
Telephone: +61 3 9288 5555  
Facsimile: +61 3 9288 6666  
www.kpmg.com.au

Mr Kevin Stevenson  
Chair  
Australian Accounting Standards Board  
PO Box 204  
Collins St West VIC 8007

Our ref Submission – ED 238

12 July 2013

Dear Kevin

**Submission - ED 238**

We are pleased to have the opportunity to comment on ED 238 *Consolidated Financial Statements – Australian Implementation Guidance for Not-for-profit Entities* (ED 238) issued by the Australian Accounting Standards Board.

Overall we agree with the basic principle of adding an appendix to AASB 10 *Consolidated Financial Statements* (AASB 10) to explain and illustrate how the principles in the Standard apply from the perspective of not-for-profit entities without actually changing the fundamental principles of AASB 10. However, we do have concerns about the application of these principles, in particular to the examples highlighted below. Our comments are outlined below and included in more detail in Appendix 1 and 2:

- Certain examples contained within the ED, more specifically example IG1 and IG2, do not appropriately apply the principles of AASB 10. The purpose and design of the entities in these examples have not been adequately addressed, the relevant activities are not clearly articulated and classification of rights as substantive or protective in nature is questionable.
- We note that the application of AASB 10 is complex for the private sector and that it is important that the AASB does not inadvertently establish precedent via the not-for-profit guidance that may not have widespread support internationally, so it may be more appropriate for the more contentious examples around state control of local government to have clearer fact patterns that leave less interpretation.
- When working through the more complex and unclear examples provided within the ED we would encourage the AASB to also consider the general principles contained within

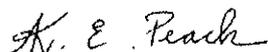
AASB 10, particularly the principles relating to agent and principle or defacto control as these principles may assist in providing further clarity on contentious areas.

- Application of the new Standard is complex, requires a significant amount of judgement and may change the control conclusion for certain entities, accordingly we consider that a mandatory effective date of 1 January 2014 will not give preparers sufficient time to be able to appropriately apply the new Standard. We would encourage the AASB to allow for an effective date of at least two years from the date of issuing the final standard.

Our comments on the specific matters raised for comment and on other issues are set out in Appendix 1 and 2.

We would be pleased to discuss our comments with members of the AASB or its staff. If you wish to do so, please contact Carol Warden on (02) 9335 8402.

Yours sincerely



Kris Peach  
Partner

## Appendix 1

Topics that the AASB has requested specific comments on:

- whether Australian implementation guidance for not-for-profit (NFP) entities should be added to AASB 10 and AASB 12 and, if so, whether it should, as proposed, be authoritative (i.e. “integral” to the Standard) or non-authoritative material;

*Overall we support the proposals outlined in ED 238 and would support the proposals being authoritative.*

- whether the proposed implementation guidance appropriately explains the definition of ‘control’ in AASB 10 for application by NFP entities, including the following aspects:
  - i. the broad nature of returns from a controlled NFP entity, including non-financial and indirect benefits (paragraphs IG16 and IG17); and
  - ii. the four detailed sets of implementation examples in the proposed Appendix E for AASB 10;

*We consider that the proposed guidance appropriately explains the definition of ‘control’ in AASB 10 including the broad nature of returns. However, the examples of returns predominantly focus on public sector NFP application compared to examples within the private NFP sector. We would encourage the AASB to provide additional examples of returns, covering a broader range of entities for example companies limited by guarantee. Within Appendix 2 in the discussion relating to Example IG1 we provide such an example in relation to a school that establishes a foundation. Inclusion of this example within the ED, together with others may be useful.*

*With the exception of Examples IG1 and IG2, we consider that the proposed implementation guidance appropriately explains the definition of ‘control’ in AASB 10 for application by NFP entities. Please refer to Appendix 2 for more details regarding our concerns relating to Example IG1 and IG2.*

- whether the proposed implementation guidance appropriately explains the definition of ‘structured entity’ in AASB 12 for application by NFP entities;

*We consider that the proposed guidance appropriately explains the definition of a ‘structured entity’ in AASB 12 for application by NFP entities.*

- whether it is appropriate to exclude all disclosure requirements in AASB 12 in respect of GGS financial statements (see the proposed amendments to AASB 1049 set out in the ED);

*We consider it appropriate to provide an exemption from AASB 12 disclosures for GGS financial statements on the basis that such disclosures would essentially duplicate the AASB 12 disclosures for the whole of government.*

- whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, including GFS harmonisation issues;

*We consider that the proposals address all the relevant regulatory issues or other issues in the Australian environment that may affect the implementation of the proposals, including GFS harmonisation issues*

- whether, overall, the proposals would result in financial statements that would be useful to users;

*We consider that the proposals would result in financial statements that would be useful to users.*

- whether the proposals are in the best interests of the Australian economy; and

*We consider that the proposals would be in the best interests of the Australian economy*

- unless already provided in response to the above specific matters for comment, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative.

*We consider that the benefits of the proposals would outweigh the costs and would not be overly onerous from a cost perspective in comparison to the current requirements.*

## Appendix 2

In addition to the comments highlighted above we have the following additional comments:

	Paragraph(s)	Issue noted	Recommendation
1	<b>IG6</b>	This paragraph as currently worded seems to indicate that a State government would generally not have power to direct the relevant activities of a local government. This seems to contradict IG2 which requires an entity to apply the general principles contained within AASB 10 when assessing who has power over a local government.	We recommend that this example is removed.
2	<b>Example 1G1</b>	<p>We have the following concerns with this example as currently worded:</p> <p><i>Purpose and design and identification of relevant activities</i></p> <ul style="list-style-type: none"> <li>• As part of the control analysis, the purpose and design together with the identification of relevant activities of the association including the impact of rights arising from any contractual arrangements in place have not been appropriately considered. We consider these steps to be critical in the control analysis [AASB 10.B3, B5-B8, BEx1].</li> <li>• Consideration as to whether the religious organisation has the ability to change the constitution of the association and what impact this would have on the control analysis should be addressed. The capacity to change the constitution to enable change in appointment of directors is likely to be critical to the assessment of power.</li> </ul>	<p>We recommend the following in respect of our concerns:</p> <p><i>Purpose and design and identification of relevant activities</i></p> <p>The purpose and design of the structure should be specifically addressed as we consider it be to a key element in the control analysis and more specifically the determination as to what the relevant activities are. For example, assume the same fact pattern as IG1 except that the board of governors consists of 10 people, 2 appointed by the religious organisation and the remaining 8 are considered to be independent of the religious organisation. Based on this fact pattern and applying AASB 10, there are two possible arguments that could be put forward when considering the purpose and design, the relevant activities and who ultimately controls the association:</p> <p>(1) the association has been set up to achieve a specific objective i.e. the purpose and design is to provide low cost housing and since this objective has been set up at inception one could argue that while the association</p>

	<p><i>Basis for concluding power exists</i></p> <ul style="list-style-type: none"> <li>The first paragraph of Example IG1A concludes that the religious organisation controls the association by virtue of the fact that the organisation has rights that give it the current ability to direct the relevant activities of the association. The example does not elaborate as to what specific rights give the organisation power. In order to understand the outcome the example should identify the key relevant activities that have been assessed and why the religious organisation is considered to have power.</li> </ul> <p><i>Exposure to variable returns</i></p> <ul style="list-style-type: none"> <li>Example IG1A states that the religious organisation has never received (and cannot receive) a financial return. We do not agree with this comment because while the organisation does not have a direct financial return, we do consider it to have an indirect financial benefit by virtue of the fact that the religious organisation has the ability to direct where the returns go i.e. it must be used for the community housing program and in the event of a wind up would generally be able to direct where any remaining assets should go. Whether financial returns are made to the religious organisation and then distributed to a 3<sup>rd</sup> party or whether the funds are distributed at the religious organisation's request to a 3<sup>rd</sup> party should not result in a different accounting outcome.</li> </ul>	<p>has the ability to make many of the day-to-day decisions it is operating within a defined framework as to where the funds are obtained from, to whom the funds can be distributed to and accordingly has no relevant activities that impact the variability of returns (everything has effectively been pre-determined). Therefore, the association could be considered to be an extension of the religious organisation itself. This together with the fact that the religious organisation, while not directly receiving any financial return from the association is exposed to variable returns by virtue of the fact that it directs where the returns go and there is congruence of objectives results in the religious organisation having control.</p> <p>(2) the association is considered to have relevant activities and is not merely operating under a defined framework determined at the initial set up by the organisation. Accordingly, an analysis must be performed in order to determine who has rights over those relevant activities and assuming it is not the organisation who holds these rights, one would conclude that the organisation does not control the association.</p> <p>The purpose and design of the structure becomes very important in determining which of these two alternatives is the most appropriate for the facts and circumstances.</p> <p>We have seen similar fact patterns where schools have established separate foundations, with independent boards, but the funds raised can only be used for capital projects of the school. In our view without consideration of the specific purpose and design of the foundation, the conclusion could be reached that there are relevant activities and that the school does not have control. However, in our view where</p>
--	---	---

			<p>the benefits can only be returned to the school and the framework of what can be done by the foundation is established at set up then we consider that the school has control, as there are no relevant activities, and should consolidate the foundation.</p> <p>As illustrated above, the consideration of purpose and design is a key aspect to be considered in the control analysis and we would recommend that the examples provided include a discussion in this regard.</p> <p><i>Basis for concluding power exists</i></p> <p>We recommend that the paragraph is reworded to provide guidance as to what facts and circumstances result in the organisation having control. For example, is it the ability to appoint 8 members of the board of governors or the owning the land and contributing funds etc? Furthermore, we recommend that the paragraph is reworded to say initially that the religious organisation has power, on what basis it has power and only conclude at the end, after the discussion on all three aspects of control that the organisation controls the association.</p> <p><i>Exposure to variable returns</i></p> <p>We recommend that the example is reworded to include the additional reason as to why the exposure to variable returns test has been met – the ability of the religious organisation to direct where returns of the association go.</p>
3	IG12	The paragraph concludes that the power to enact or change legislation, and having rights specified in merely substantively enacted legislation, do not give the investor power. Additional explanation as to why this is the case would be helpful. It may be useful to contrast this to the unfettered ability of an entity to change the constitution of	We recommend that the paragraph include additional explanation as to why the power to enact or change legislation and having rights specified in merely substantively enacted legislation do not give rise to power. We note that this is one of the key interpretive elements of the guidance and it's important not to inadvertently create a

		<p>one of its investees (see discussion on Example IG1) to determine the composition of the board of directors which may result in obtaining power.</p>	<p>for-profit precedent. Reference to whether the power is currently exercisable may assist (i.e. legislative reform requires approval from parliament, substantive legislation may or may not give rights that are currently exercisable, depending on when the legislative change is effective.</p>
4	<p><b>Example IG2</b></p>	<p>We have the following concerns with this example as currently worded:</p> <p><i>Purpose and design and identification of relevant activities</i></p> <ul style="list-style-type: none"> <li>As part of the control analysis the purpose and design together with the identification of relevant activities of the Council, including the impact of rights arising from any contractual arrangements in place have not been appropriately considered. We consider these steps to be critical in the control analysis.</li> </ul> <p>For example, if the ability to raise revenue outside of rates is restricted and required to be approved by the State then given the boundary constraints (i.e. State has unfettered ability to change boundaries which determines the volume of rates that can be charged) and the ability to cap revenue raised from rates it can be argued that the amount of revenue is limited/determined by the State and accordingly there are no relevant activities of the local government that impact the variability of returns (i.e. allocation of capped revenue is arguably not a relevant activity, as although the composition of where the monies may be spent may change, the actual quantum of spending is not able to be influenced by Council).</p> <p>In such circumstances, even though the Council is making a number of day-to-day decisions which impact returns these decisions may not be considered to be</p>	<p>We recommend that the example is reworded to include consideration of the purpose and design of the entity, identification of relevant activities, and additional guidance as to why certain rights have been determined to be protective. A helpful starting point may be that to the extent to which the right is only exercisable with cause e.g. in the event of an unlawful act, or other actions outside of the control of the entity who has the right it should be considered to be protective in nature and reassessed at the point in time when, and if, the default occurs – at that point the rights may be considered to be substantive. Similarly, rights which can be exercised without cause may be more akin to substantive rights.</p> <p>If the purpose of the example is to provide a clear example of where the State does not control local government then we recommend you change the fact pattern to make it clearer regarding the purpose and design that there is no capping on revenue from rates and that revenue from other sources is not dependent on approval from state governments.</p>

		<p>decisions over relevant activities as these have already been set by the State and therefore are considered to be irrelevant in the control analysis. The State is setting the framework under which the Council operates and accordingly there are no relevant activities.</p> <p>Based on the facts provided we do not consider the analysis to address the purpose and design concerns noted above, therefore we do not agree with the conclusion reached.</p> <ul style="list-style-type: none"> <li>• Some of the protective rights appear more substantive in nature. We consider that under AASB 10 unfettered rights to change or step in are likely to be substantive rather than protective. Generally where there are conditional rights they are more likely to be protective [AASB10.14, B22-B28].</li> <li>• Accordingly we would consider the right to restructure the Council through boundary changes a relevant activity as based on the facts it is an unfettered right, and where the State is able to change the boundaries without cause in our view is more akin to a substantive right than a protective right. Furthermore, we would also consider the ability to appoint inspectors of municipal administration without cause to be more akin to a substantive right than a protective right. Where it is conditional on issues with management etc. then we would consider the rights to be more protective in nature.</li> </ul>	
5	<b>Basis for conclusions</b>	<p>Insufficient explanation/background as to why certain Aus specific paragraphs contained within AASB 127 were not replicated in ED 238 or not replicated verbatim, for example:</p>	<p>The Basis for Conclusion should set out the rationale for specific paragraphs not being carried forward.</p>

		Aus 17.2 – discussion as to why accountability is not given specific prominence when applying the new control model.	
--	--	--	--