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A WHK Group Firm

26 June 2013

Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West VIC 8007

By email: standard@asb.gov.au

Dear Mr Stevenson

Invitation to comment – ED 238 Consolidated Financial Statements - Australian Implementation Guidance for Not-For-Profit Entities

Crowe Horwath is pleased to provide the Australian Accounting Standards Board with its comments on Exposure Draft ED 238 Consolidated Financial Statements - Australian Implementation Guidance for Not-For-Profit Entities ("ED 238").

Crowe Horwath provides a complete range of accounting, advisory, tax and wealth management services. Crowe Horwath comprises more than 800 principals and professionals located in Australia and New Zealand and is part of the national WHK Group, which is listed on the Australian Securities Exchange and is the fifth largest accounting services group in Australia.

We are supportive of the Board's aim of providing additional implementation guidance on AASB 10 *Consolidated Financial Statements* to not-for-profit ("NFP") entities. However, we do not believe the proposals clearly and adequately explain the concepts as they apply to NFP entities. For example, two of the four illustrative examples (universities and local councils) are too narrow in their application and are not particularly helpful to the broader NFP sector. We would prefer the inclusion of broader, more common scenarios that would assist a wide range of users. We also suggest that the Board clarify a number of application aspects contained in the ED.

Our detailed comments on the proposals are included in the attached Appendix.

We would be pleased to discuss any aspect of our submission with you further at your convenience.

Sincerely,
Crowe Horwath

A handwritten signature in black ink, appearing to read 'Martin Olde'.

Martin Olde
Partner



APPENDIX

Specific matters for comment

- A. *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 (ie “integral” to the Standard) or non-authoritative material;*

We are supportive of the inclusion of additional implementation guidance on AASB 10 *Consolidated Financial Statements* to not-for-profit entities.

Due to the varying nature of NFP entities, we are concerned that the examples can not contemplate all the various factors that need to be considered in assessing control. Hence, if the guidance is authoritative there is a risk that preparers and users may apply a conclusion based on the examples that is not appropriate in the actual specific circumstances. Therefore, we suggest that the guidance be non-authoritative material.

- B. *Whether the proposed implementation guidance appropriately explains the definition of ‘control’ in AASB 10 for application by NFP entities, including the following aspects:*
- (a) The broad nature of returns from a controlled NFP entity, including non-financial and indirect benefits (paragraphs IG16 and IG17); and*
 - (b) The four detailed sets of implementation examples in the proposed Appendix E for AASB 10;*
- and
- C. *Whether the proposed implementation guidance appropriately explains the definition of ‘structured entity’ in AASB 12 for application by NFP entities.*

We do not believe that the proposed guidance clearly and adequately illustrates the definition of control for application by NFP entities. By their nature, not-for-profit entities, whether in the public sector or private sector, often display unique characteristics that are not prevalent in the for-profit sector. In our opinion, Examples 3 and 4 (universities and local government) are too narrow and entity specific and are of limited benefit and application to the broad NFP sector. We would prefer the Board provide illustrative examples of scenarios that are more common in practice and relevant to a broader constituency. For example:

- It can be difficult to establish statutory or contractual arrangements between entities within the same religious order. While an intuitive assessment may lead to a conclusion that the head religious body controls the activities of the entities within that religious order, such power may not arise from voting or equity rights (in the corporate sense) nor statutory or contractual arrangements. Hence, applying the factors discussed in AASB 10.11 may lead to an alternative view.

We suggest that additional guidance on the relative weightings of the factors described in AASB 10.B18 and B19, as well as recognising that power may be derived from other ‘non-traditional’ factors in the context of NFP entities would assist users and preparers.

- The narrow purpose and design of an entity established by a non-for-profit entity may make it difficult to clearly identify the ‘relevant activities’ over which the parties may have control.

Some not-for-profit entities are established with pre-determined, well defined and narrow objectives. We believe it would be useful to constituents for the Board to clarify and provide further guidance on the application of the principles referred to in IFRS 10.BC80 to not-for-profit entities, especially where the financial returns are not the key purpose of establishing the entity.

- Appendix E [for AASB 12] discusses structured entities. We agree with the statement in IG6 of Appendix E which states:

“... for not-for-profit entities, structured entities have been designed so that less conventional means – in the context of not-for-profit entities – are the dominant factor in determining who controls the entity. Therefore, in the not-for-profit context, the reference in the definition to “similar rights” encompasses administrative arrangements and statutory provisions, as these often are the dominant factor in determining control of not-for-profit entities.”

However, there does not appear to be discussion of what are “less conventional means” and how they are analysed in determining control in the context of AASB 10. Consistent with the points above, we suggest that this concept be specifically included in the NFP guidance within AASB 10.

- AASB 10.B8 acknowledges that voting rights may not be the dominant factor in deciding who controls an investee and that the relevant activities may be “directed by means of contractual arrangements”. Given the comment above, we suggest the AASB clarify whether, for NFP entities, such assessments are limited to the existence of ‘contractual arrangements’ or whether non-contractual arrangements and other “less conventional means” could still give a party control over an investee. (see also examples below)

As discussed above, a religious organisation may have the practical ability to direct the activities of an investee notwithstanding such ability does not arise from ‘statutory or contractual arrangements’. To aid a broader group of users, we suggest more common examples of NFP relationships be included to illustrate the concepts discussed, such as:

Example 1:

NFP is a private sector not-for-profit organisation whose objectives is the provision health services to the sick and injured and provides first aid training to the community. NFP establishes NFPE, a company limited by guarantee, whose sole objective is to teach first aid to school children. The Board of NFPE comprises like-minded individuals but who are not directors of NFP. Vacancies on the Board of NFPE are decided by a majority of NFPE’s directors. Other than appointing the initial Board of NFPE, NFP does not have the power to remove or appoint the directors of NFPE. NFPE’s sole source of funding is donations from NFP and NFP donates training equipment and logistical and administrative support to NFPE. NFPE decides which schools it will visit and the types of first aid training it will deliver.

Some suggest that NFPE is an extension of NFP and should be consolidated by NFP. It is viewed as a structured entity that has been established by NFP for the furtherance of its objectives and whose existence is dependent upon the continued support of NFP. NFP can exercise power over the activities of NFPE by varying the level of funding and other support it provides to NFPE. Further, one could argue that NFPE is, in substance, an agent for NFP in furthering NFP's objectives and can effectively remove NFPE simply by terminating funding and support and refer to IG20(a) to support this proposition. However, applying the guidance described in IG9 (economic dependency), IG10 (financial dependency), IG14 (protective rights) and Example IG2 (local council), one might conclude that NFP does not control NFPE.

Example 2:

NFP sets up an entity to provide services to NFP (whether it be catering / training / recruitment services) and NFP initially is the only user of that entity's services. The entity is unable to direct profits back to the NFP. NFP is able to set the prices for which the entity charges its services (which therefore determines the profits and manages their costs) and set service standards/requirements. However, the NFP can not appoint a majority of the members of the board of the entity. Applying the rationale in Example IG1, one would conclude that NFP does not control the entity because the voting process does not give NFP the power to appoint board members. However, others would suggest that the entity is an extension of the reporting entity that should be consolidated with that of NFP.

Example 3:

Schools, elite sporting organisations and the arts establish foundations to raise funds that are directed towards the creator NFP although their Constitutions do not prohibit alternative directions of funds. In many cases the governing board of the foundation contains a majority of high-profile business, political or sporting persons that support the objectives of the NFP but would be assessed as being independent of the NFP. In the absence of voting rights or other 'contractual arrangements' that give the creator direct power over the foundation, it could be suggested that the NFP does not control the foundation.

Under AASB 127 and Interpretation 112, all three examples above would generally be consolidated with the NFP, although for the reasons above, a different view may be taken under the Exposure Draft.

Given the potential impact on the NFP sector, we strongly suggest that the Board clarify:

- a) whether the accounting for such arrangements would likely change under AASB 10, and if so why; and
- b) under what circumstances members of the governing board of the foundation (or similar entity) would be considered nominees of the NFP.

Given the potential inconsistency between the statements in IG 6 in Appendix E for AASB 12 and AASB 10.B8, referred to above, we suggest that the Board clarify its views in the final standard.

- We are concerned that some of the examples contained in the proposals appear to start with a conclusion that is consistent with current practice and then attempts to justify that conclusion. However, the arguments used in some of those examples either appear to be inconsistent or may require further information and clarity so that the principle supporting the AASB’s reasoning is more transparent.

We suggest that the Board clarifies the operation of the following aspects of the implementation guidance:

Reference	Comments
IG5, Example IG1	<p>“As an example of contractual or statutory arrangements, a not-for-profit investor often will have power over an investee that it has established when the constituting document or enabling legislation specifies the investor’s rights to direct the operating and financing activities that may be carried out by the investee. However, the impact of the constituting document or legislation is evaluated in the context of other prevailing circumstances, as all facts and circumstances need to be considered in assessing whether an investor has power over an investee.” (IG5)</p> <p>While IG 5 suggests that such rights are not conclusive in assessing control, the conclusions in Example IG1 appear to focus on voting rights as determinative of control. Eg, Example IG1A suggests that control does exist because of the existence of such rights. Alternatively, Example IG1B suggests that control does not exist due the inability to appoint board members.</p> <p>We believe it would be useful to constituents for the Board to more clearly articulate the key determinants of control.</p>
IG8	<p>The example in IG8 suggests that the government has control over the statutory authority, but it is unclear on what basis that determination is made.</p>
IG2	<p>Example IG2 provides a scenario where a Minister can “give directions concerning rates and charges so as to limit the Council’s general income for a financial year”. Setting aside government grants, the power to determine the amount of total rates and charges is clearly a relevant activity that affects the investee’s returns.</p> <p>How the total rates and charges are divided across different categories of constituents does not change the fact that, in this scenario, the power to limit total income is a major substantive power that does <i>significantly affect</i> the Council’s returns.</p> <p>We would suggest that the allocation of rates across constituents is only an administrative decision, would not significantly affect the overall returns of the Council, and would not be a key determinant in assessing control.</p>

IG 12, IG11	<p>“Paragraph B24 states that to be substantive, rights need to be exercisable when decisions about the direction of the relevant activities need to be made. Usually this means that the rights need to be currently exercisable. However, paragraph B24 also notes that sometimes rights can be substantive even though they are not currently exercisable. For many not-for-profit investors, power over an investee may be obtained from existing statutory arrangements. <i>Neither the power to enact or change legislation nor rights specified in merely substantively enacted legislation give the investor the current ability to direct relevant activities of the investee.</i>” (IG12) (emphasis added)</p> <p>We suggest that the Board clarifies why it believes that the power to enact or legislate change does not give the investor control, even of such power is currently exercisable (eg, the government has a majority in both Houses). Does the Board’s view alter if the statutory instrument is a Regulation or instrument that may be issued by a Minister rather than legislation passed by Parliament, and if so, why?</p> <p>In addition, it would be helpful for the Board to clarify how that statement in IG12 is reconciled to AASB 10.B24, including Application examples Example 3 within that paragraph, as well as the indicators in paragraph AASB 10.B23. It is unclear how the mere passage of time does not preclude the existence of currently exercisable rights, but the current ability to issue a regulation or statutory instrument does (especially if the conditions in B23 are satisfied).</p> <p>Further, in the case of amending legislation or regulations, there may be scenarios in which all the indicators in B23 would indicate the existence of substantive rights, although such power is expressly excluded from the assessment in IG 12.</p> <p>We contrast the scenario described in IG12 (that is, that the power to enact change does not give the investor the current ability to control) and the comment that “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 IG11.</p> <p>We believe there is a fine distinction between these two concepts and it would be helpful to constituents for the Board to clarify the difference between having the <i>ability</i> to direct the activities but being subject to barriers to exercise that ability, and the investor’s ability to exercise power by passing legislation or other instruments that are within its ability to do so. In both cases, the investor may have the right to exercise its power to direct the relevant activities of the investee but chooses not to do so.</p>
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