



28 June 2013

Mr Kevin Stevenson  
Chairman  
Australian Accounting Standards Board  
PO Box 204  
Collins St West Victoria 8007  
AUSTRALIA

Dear Mr Stevenson

**AASB Exposure Draft ED 238: Consolidated Financial Statements –  
Australian Implementation Guidance for Not-for-Profit Entities**

Please find attached the Australasian Council of Auditors-General (ACAG) response to the Exposure Draft referred to above.

The views expressed in this submission represent those of all Australian members of ACAG.

Overall, ACAG is supportive of the proposals in ED 238. Attached are views on the specific matters for comment.

The opportunity to comment is appreciated and I trust you will find the attached comments useful.

Yours sincerely

A handwritten signature in black ink, appearing to read 'S O'Neill', is written over a light blue horizontal line.

Simon O'Neill  
**Chairman**  
**ACAG Financial Reporting and Auditing Committee**

## Specific Matters for Comment

- 1. 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.**

ACAG supports the inclusion of the implementation guidance for both AASB 10 and AASB 12. ACAG agrees with the proposed approach for both sets of guidance to be integral to the standards in the interests of consistent application by NFP entities.

ACAG also supports the guidance being included as separate appendices as opposed to numerous Aus paragraphs being incorporated in either the main body of the standard or in existing appendices. This is consistent with the principle that Aus paragraphs in the body of the standard should only be used to amend requirements or add new requirements. Also, the quantity of guidance material proposed for AASB 10 would significantly lessen the readability of the body of the standard or Appendix B if it were to be dispersed throughout these.

ACAG considers the AASB would be justified to mandate that the appendices be adopted at the same time as AASB 10 and AASB 12 are adopted, in the interests of consistent application of the guidance.

- 2. 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.**

In general, ACAG considers that the proposed guidance adequately explains the three concepts of control in AASB 10, being power, variable returns and ability to use power to affect returns.

The guidance for the concept of “*rights that give an investor power over an investee*” appropriately acknowledges that for many NFP entities in the public sector, rights are created from statutory arrangements such as enabling legislation. However, whether these rights are substantive or protective rights and whether they relate to relevant activities requires judgement. Preparers and auditors of financial statements will benefit from guidance material that aids professional judgement and effective decision making.

ACAG provides the following comments:

- Paragraph B14 of AASB 10 requires the investor to have existing rights that give the investor the current ability to direct the relevant activities of the investee. In addition to the example provided in IG8 and the implementation examples, it would be beneficial if the guidance included more illustrations of relevant activities for NFP entities.

- In order to determine if an activity is a relevant activity, it would be beneficial to include benchmarks or parameters that give further guidance that helps determine whether or not the investee's returns are significantly affected.
- IG7 provides additional examples of rights that can give an investor power. ACAG suggests that further guidance of how to apply B15 examples would be beneficial. In particular, B15(d) "*rights to direct the investee to enter into, or veto any changes to, transactions for the benefit of the investor*", requires judgement as to what are benefits to the investor. A government may be able to direct a statutory authority to perform a certain function or transaction (deliver government services), which would benefit the government.
- IG10 suggests that a government may not have the ability to direct the relevant activities of a financially dependent entity, if the investee's governing body has ultimate discretion over the activities. However, better practice financial governance would require that every governing body has ultimate discretion of all the entity's activities, as they have the responsibility for the oversight of the entity's operations and discharge of responsibilities. Therefore, the inference that the independence of a governing body is a distinguishing factor to determine power over an investee may not be valid in all circumstances, and has the potential to be misinterpreted in the NFP sector.

**(a) Broad nature of returns from an investee**

Paragraphs IG16 and IG17 state that an investor's return from its investee can be broad, and can include non-financial returns and direct or indirect benefits. In addition, returns can include the achievement or furtherance of the investor's objectives. However, there is limited material in either Appendix B of AASB 10 or the proposed Appendix E which assists in understanding non-financial returns. Further discussion of the nature of variable returns than that provided in IG16 and IG17 could be warranted.

Where returns comprise, for example, the furtherance of the investor's objectives, guidance on how to differentiate between negative returns and no returns may be helpful. It would also be beneficial to include how the achievement of the investor's objectives is to be determined or measured.

Appendix B paragraph B57(c) of AASB 10 infers that an investor may derive returns which the investee may not itself be primarily driven towards. ACAG presumes this tries to demonstrate the concept of indirect returns. It would be helpful to explicitly state that returns to the investor do not need to directly relate to the investee's returns.

**(b) Implementation examples**

Overall, the implementation examples are helpful in understanding the requirements of AASB 10, and how to apply them to NFP entities. However, there are some issues where it would be helpful to explain through the examples, and some areas which would benefit from further clarification.

*i. Example IG 1A & 1B – Community housing association*

ACAG supports the notion that returns to an investor that are non-financial in nature are of value to the investor. While we agree that the achievement of social objectives is a relevant example of a non-financial return, we note that Example IG1 is the first time this concept is introduced in the guidance, which is not explained until paragraph IG16.

*ii. Example IG 2 – Local Government Council*

ACAG supports Example IG2 as a demonstration of the application of the control concepts to the NFP sector. In particular, the example illustrates the importance of determining whether the investor has substantive or protective rights related to the investee.

What becomes apparent in the example, is the judgement required to determine whether the State Government can direct relevant activities that significantly affect the Council's returns. This example raises the issue of what constitutes directions of relevant activities by an investor to an investee in the NFP sector. In a NFP context, differentiating between 'directing' relevant activities and the ability to give directions which relate to relevant activities will be at times complex.

The example refers to the Minister's ability to give a direction that limits the raising of rates collected from ratepayers, but concludes that this does not have a major effect. It could be argued that if the Minister gave a direction to limit the raising of rates collected from ratepayers, then this may constitute the direction of relevant activities, as it could have a significant impact on the Council's ability to deliver services to the community, and consequently the Council's returns.

There is potential for divergent application of this concept without the setting of parameters or further guidance on what constitutes "direction" of a relevant activity. This is because the notion of returns of an investee, where they are non-financial, may be difficult to objectively identify.

Further, ACAG questions the validity of the assumption used in Example IG2 that the objectives of the State Government and Local Governments are aligned.

*iii. Example IG 3A & 3B – University*

ACAG supports Example IG3 as a demonstration of the application of the control concepts to the NFP sector, in particular, the concept of rights that give an investor power over the investee.

The issue of indirect returns would be beneficial to apply to the university illustrative examples. Example 3A states that '*The State Government's objectives for the activities of the University are consistent with those specified in the Act for the University*' (p.26).

It would be useful to clarify whether they are perceived to directly correlate with those objectives in the Act, or whether the provision of the university's returns necessarily produces returns for the investor.

Incorporating a specific example of returns to an investor which are not directly aligned with the objectives of the university could assist in understanding that such returns should not be

overlooked in ascertaining who has control. An example could be State Government's returns from universities attracting international students. This improves the State's economy, can improve the State's image as a desirable tourist destination, and may facilitate development in the form of student housing, all of which would not be returns the university is primarily aiming to achieve. It could be helpful to apply this scenario to the existing illustrative examples.

Another factor which may be helpful to incorporate is the potential complexity in evaluating differing returns for different investors. For example, the Australian Government may achieve broad policy objectives through its support of universities, whereas a State Government may see its key returns as being related to the State's economy and supply of tertiary-educated people into the State's workforce. Regardless, Example IG3B would benefit from clearer articulation of the nature of the returns being obtained by the State.

What is not clear in the example is whether the University Council's responsibilities, powers and functions are established by the university's enabling legislation, or by the Council itself. ACAG believes that this is an important factor that needs to be considered, because if the enabling legislation sets the powers and functions, then this may be evidence of the State Government's rights to direct the relevant activities of the university.

In paragraph IG8, it is explained that, in the context of the Auditor-General or the judiciary, legislation governing the establishment and operation of an independent statutory office and setting out the broad parameters within which the office is required to operate, results in parliament having the ability to direct the relevant activities of the office. What is the difference compared to an Act of the State that establishes a University?

The suggested solution refers to the Australian Government's grant agreements as protective rights due to the condition that allows misapplied funds to be reclaimed. However, this is not the only condition of these grant agreements, with the primary condition being that universities are required to perform education or research activities. The Australian Government can direct how many students are educated, and what type of research is performed. For example, the Australian Government could direct universities to only teach domestic students. Further, a university that performs poorly may not be awarded funding in the future, directly impacting the activities of the university. Consideration of such factors would assist in the usefulness of this example.

*iv. Example IG 4A & 4B – Hospital*

ACAG supports Examples IG 4A & 4B as effectively demonstrating the impact of delegated powers on NFP entities. ACAG agrees with the conclusions reached and the distinguishing factors.

Example IG 4A identifies a situation where a statutory authority would be consolidated at a whole of government level while not being consolidated by the Department. ACAG believes it may be helpful to expand this example, or include a separate example, which considers collective rights at a whole of government level. There are some situations where the powers of a single Minister or Department are unlikely to support the Minister having control but, when viewed in conjunction with the powers of another Minister or Department at the whole of government level, may result in a conclusion that the government as a whole controls the entity concerned.

- 3. Whether the proposed implementation guidance appropriately explains the definition of ‘structured entity’ in AASB 12 for application by NFP entities.**

ACAG considers that the guidance is necessary and appropriately explains the definition of ‘structured entity’. However, we suggest simplification of the wording in IG6.

- 4. 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).**

ACAG considers the proposal to exclude all disclosure requirements in AASB 12 in respect of GGS financial statements as appropriate.

- 5. 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.**

ACAG is not aware of any such issues.

- 6. Whether, overall, the proposals would result in financial statements that would be useful to users.**

The proposals support a more consistent interpretation of Australian Accounting Standards in relation to control, which in turn is useful to users. This is likely to lead to better comparability between entities, which is beneficial to users. Further, the guidance in defining control seems to be appropriate to support useful information to users in terms of what would be considered controlled.

- 7. Whether the proposals are in the best interests of the Australian economy.**

ACAG considers the proposals are in the best interests of the Australian economy.

- 8. 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.**

In relation to the proposed guidance for AASB 10, ACAG considers that the proposals will provide benefits to preparers and auditors. The application of AASB 10 to NFP entities has potential to be costly to implement, due to shifting from a (at times) rules-based approach under previous standards (for example, local governments not being under the control of state governments) to a more principles-based approach. However, the implementation guidance in ED 238 assists in interpreting such requirements, and will therefore assist in minimising costs.