



31 March 2023

Dr Keith Kendall
Board Chair
Australian Accounting Standards Board

Via email: Standards@asb.gov.au

Dear Dr Kendall

ITC 51 – Post-Implementation Review of Not-for-Profit Topics - Control

Our comments and recommendations regarding the PIR invitation to comment are provided in this submission.

Saward Dawson operates in Melbourne, Australia. Our clients come from a range of industries and include large private businesses, small to medium enterprises, and a significant number of private sector not-for-profit entities. We are focused on enhancing the relevance, reliability and understand ability of financial reporting for users.

Saward Dawson is widely recognised as a firm with clear expertise in the not-for-profit private sector space for over 20 years. We work with hundreds of charities and other not-for-profit entities. We aim to actively advocate on behalf of the sector. Our involvement includes:

- AASB NFP PAP member
- ACNC Professional Advisors Group
- Chair of CAANZ NFP Discussion Group Melbourne
- Chair Not-For-Profits Accountants Network

Through our involvement with our client base and other NFP networks we think that the current application of control in the NFP sector is the most significant issue when considering the removal of special purpose financial reporting. A survey at a reporting webinar we conducted indicated over 20% of participants were concerned. Given that many NFPs do not have any associated entities, this demonstrates the significance of the issue.

Please do not hesitate to contact us should you wish to discuss further any matters arising from this submission.

Yours Sincerely

Jeff Tulk
Partner

Appendix 1

In summary we hold the following views:

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?
- 2 difficulties that might be experienced in identifying and consolidating controlled entities, including difficulties accessing necessary information?
- 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.
- 4 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.

We are aware of many organisations who prepare special purpose financial reports that do not apply AASB10. The primary reason for this is that the directors do not think consolidated reports provide meaningful and useful information to their primary users. In many cases they believe it will distort the ability of the users to understand the financial performance of the organisation that they are concerned with.

Specific examples include the following:

- A religious denomination who considers its primary users to be the local churches belonging to that denomination. Based on its ability to nominate or requirement to approve board members it could be determined under the current the requirements of Appendix E and in particular example IG1 to control multiple schools, a theological college and a significant aged care and social services entity. The consolidation of these entities would totally obscure the operations of the religious denomination. These entities hold difference in charitable purposes, for most there are no financial transactions or economic dependence between denomination and the other entities and no ability for variable financial returns or provision of funds on wind-up exist due to different charitable purposes.
- An independent church that currently consolidates a related PAF and community counselling entity on the basis that the funders of these entities are typically the same, key management is the same and the primary users (church members) would consider these entities as a group. However, it does not consolidate a school as the users of the school's financial report (parents and regulators) are different to the church. They have not identified any party that would benefit from consolidated reports that include the school and variable financial returns or provision of funds on wind-up do not exist due to different charitable purposes.
- A member based organisation providing group purchasing supply business into the education sector historically established a foundation where funds are used to assist disadvantaged people with education. Although the KMP are the same the directors think consolidated accounts distort the financial report as entity has no ability to obtain any financial returns from the Foundation which holds a significant investment portfolio.

With reference to example above regarding the religious denomination, although it has rights to nominate or approve board members of the associated entities, this does not provide the denomination with rights to access financial information. In reality, practical control only exists to the extent of director nomination or appointment and beyond that a number of the entities operate entirely independently.

In relation to the application of AASB10 in the NFP sector we have on a number of occasions become the auditor of the entity and identified that although general purpose financial reports are stated to have been prepared, consolidation has not been applied. In most cases this is due to the issues not being considered by the previous board and auditor.

We think the application of AASB10 to the NFP sector needs to be reconsidered. The current overemphasis on the ability to appoint, nominate, approve or veto director appointments as the determinant of control does not take into account the purpose of such clauses in historic constitutions. These are often to maintain faith connection or underlying values to remain as part of the associated entities as well as assisting in identifying and nominating skilled directors from a broader network. This often does not lead to functional control or influence over operations by the "parent". It could be argued that such rights are more protective rather than substantive.

We think an alternative model is required that focuses on the following:

- Considering the primary users of the entities. Where they are the same, consolidated reports may be of use and other factors of control should be considered to determine if control exists.
- Consideration of functional and practical control where nomination and veto rights over directors is not determinative. This could include the concept of protective rights within the NFP private sector.
- A narrowing of the variable returns to focus on financial returns within Appendix E rather than the broad concept adopted. We think this overextends the application of AASB10. Variable financial returns could focus both on financial returns provided to or from the parent or subsidiary and consider the access to funds on windup.

It may be appropriate for a broad ability to apply judgement under such a model to exist. We do not think this is necessarily an issue and would recommend disclosure of entities and nature of relationships where some factors exist but control is determined not to exist. Such disclosures could also include these related party transactions and balances.

- 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.
- 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.

We refer to our comments and examples above.

We think the concept of variable returns is too wide and for the purpose of preparing a financial report the focus should be on financial returns per the for profit requirements rather than the extensively broad application described in IG18. In our view it is very difficult to argue that if a “parent” was initially involved or supported the “subsidiary” establishment that this would then not be considered as a furtherance of objectives.

Regardless of the final model adopted by the AASB we strongly recommend the following:

- i. Split the NFP private sector and NFP public sector guidance into two to avoid confusion and uncertainty about if guidance is applicable to public sector only or if the principle should also be considered by the NFP private sector.
- ii. Expand examples that provide further stepped examples. Using IG1 as a reference include the first example exclude the land / housing so no financial transactions occurs between the entities and then include in a subsequent items such as non-variable land rental arrangements or set management fees if that would result in a different determination. In the current example it is unclear if the land / housing transactions has impacted the determination.

- 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.

Many NFP’s operate funds (school building, library, cultural etc). In our experience it is common for control to exist due to the same KMP / board or for the distribution clause to not be quite restrictive. However, we think consideration of customary business practice could be a useful factor in considering variable returns.

Regarding assessing control without an equity interest, do you have any comments about:

- 8 the application of the requirements in practice?
- 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.
- 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.

Where equity interest does not exist we consider the membership rights and the ability to appoint a controlling portion of the board as key determinants based on the current version of Appendix E.

We refer to our above comments in relation to separating NFP private sector and NFP public sector guidance. We note IG17(e) is grouped with what appears to be public sector NFP guidance. We have not seen this used as a determining factor as the we do not think the concept of protective rights has been clearly considered in a private sector NFP context within Appendix E.

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.
- 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.

We do not work extensively in the public sector. Accordingly, we don't provide 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?
- 19 Does the application of the requirements considered in this ITC result in major auditing or assurance challenges?
- 20 Overall, do the requirements considered in this ITC result in financial statements that are more useful to users of NFP entity financial statements?
- 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?
- 22 Are there any other matters that should be brought to the attention of the AASB as it undertakes this PIR

As detailed in our submission we are aware of many entities that do not consolidate as they do not consider the resultant financial reports to be relevant to any users.

With reference to the above, considerable accounting effort, audit cost, will all occur upon the removal of special purpose reporting should the requirements not alter. This will add many thousands of dollars in costs to a significant number of organisations. Where no users exist for such reports we obviously question the benefit.

We also note that many entities that may require consolidation under AASB10 have different year ends based on their activities. This add further complexity and audit cost.