Tel: +61 3 9603 1700
Fax: +61 3 9602 3870
www.bdo.com.au

Collins Square, Tower Four
Level 18, 727 Collins Street
Melbourne VIC 3008
GPO Box 5099 Melbourne VIC 3001
Australia

The Chair
Australian Accounting Standards Board
PO BOX 204
Collins Street West
Melbourne VIC 8007

31 March 2023

Dear Sir

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

Thank you for the opportunity to comment on the Board's post-implementation review of the requirements applicable to not-for-profit entities in respect to control, structured entities, related party disclosures and the preparation of special purpose financial statements.

Please refer to Appendix 1 for our detailed comments on your specific matters for comment.

If you have any comments regarding this request, please do not hesitate to contact me.

Yours faithfully

ABoshoff

Aletta Boshoff
Partner

National Leader, IFRS & Corporate Reporting

National Leader, ESG & Sustainability

BDO

APPENDIX 1 – Specific matters for comment

Topic 1 - Control and consolidation for NFP entities

Questions

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?

BDO Comment - Question 1

We acknowledge the feedback provided to the AASB regarding problems encountered in practice, such as:

- Entities being required to consolidate other entities they do not believe they have genuine control over (if there is no power to control then they should not be consolidating)
- There are no shared financial liabilities or other financial consequences of the relationship, e.g. there is no economic dependence (this is irrelevant if the entity has power over the other entity, and AASB 10.IG11 notes that economic dependence by itself is not an indicator of power)
- The financial performance and position of the parent may be obscured by the subsidiary's financial performance and position (the purpose of preparing consolidated financial statements for not-for-profit entities is to present the group's financial performance and position so that donors can assess group performance against the entity's objectives).

We do not, however, consider these issues represent a basis on which not-for-entities that are parents should be exempted from preparing consolidated financial statements. In particular, we note that the concept of control can be challenging to interpret and apply to some for-profit entities, but these challenges do not necessarily prevent a determination on control being made, albeit with some judgement.

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

BDO Comment - Question 2

We acknowledge the challenges that some not-for-profit entities experience in applying the requirements in AASB 10, including access to financial information from controlled entities. Many of these challenges, however, are the same or analogous to those experienced by for-profit parent entities.

While arguments have been put forward in ITC 51 that identifying variable returns in the not-for-profit sector can be difficult, we do not agree with this assertion. AASB 10.IG18 makes it clear that in applying AASB 10.B57 to not-for-profit entities, the broad scope of the nature of returns encompasses financial, non-financial and indirect benefits, whether positive or negative, including the achievement or furtherance of the investor's objectives. Therefore, many entities 'related' to a not-for-profit entity because they undertake activities that promote or assist the not-for-profit entity's objectives will meet the 'variable returns' criteria in the control assessment. However, this does not necessarily mean they are controlled. The not-for-profit entity must also meet the 'power' criterion before it is considered to have control.

In practice, not-for-profit entities may experience difficulty assessing whether they meet the 'power' criterion, i.e. determining the relevant activities, or the activities that significantly affect returns, as this can be judgemental. However, once determined, assessing whether the not-for-profit entity has power over the relevant activities, exposure to variable returns (which are very broad), and the ability to use power to affect the variable returns, is usually straight-forward.

Charities – Time taken to perform control assessments

Having regard to our comments above, we note however, that some charities, once special purpose financial statements are scrapped, may experience difficulties undertaking this control assessments for their numerous 'related' entities. For example, many religious organisations have numerous 'sub organisations' such as congregations, schools, hospitals, food banks, etc. These essentially operate independently of each other, and of the main/head not-for-profit entity, receiving independent donations or grants, which cannot be passed from one entity to another, and cannot be used for the benefit of non-recipient entities. Nevertheless, the main/head entity will be required to conduct a control assessment for each of these 'related' entities which could be a time-consuming exercise.

Currently, these types of organisations can make use of the joint and collective reporting requirements to satisfy their ACNC reporting requirements, and if using joint reporting, may not even be applying AASB 10 (as permitted by section 60.25 of the ACNC Regulations to allow for aggregation accounting).

Charities - Inconsistency between ACNC reporting requirements for groups of a similar size

We also note that the ACNC reporting thresholds are based on revenue of the **individual registered entity.** This means that once special purpose financial statements are scrapped:

- If the head/main charity is by itself small, there is no requirement to submit financial statements to the ACNC Commissioner, so no consolidation assessment is required if the entity is a parent entity (only the Annual Information Statement is required), whereas
- If the head/main charity is medium or large, it must perform a potentially extensive control assessment, and prepare and submit consolidated financial statements if it controls other 'related' entities.

There appears to be an inconsistency in the reporting requirements in the above scenarios. Both groups could be of a similar size, yet one is required to prepare and submit consolidated financial statements, whereas the other is not.

Basic religious charities

Basic religious charities are not required to prepare financial statements. Some religious organisations, if they control basic religious charities, may be required to prepare consolidated financial statements in future. This may present challenges as these entities currently merely submit an Annual Information Statement to the ACNC and are not subject to review or audit.

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.

BDO Comment - Question 3

We have not seen differences in application in practice applying the control model and Appendix E. However, we note, that the control assessment is typically more qualitative in nature (and therefore potentially more judgemental) than for for-profit entities. Some not-for-profit entities may therefore be reluctant to do the work, and/or be uncomfortable with applying judgement when assessing control over other entities.

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.

BDO Comment - Question 4

We do not think any additional guidance is required. Unless the AASB could identify a scenario that is exclusively not-for-profit specific, providing guidance around control for not-for-profit entities runs the risk of promoting/precluding interpretations that are otherwise prohibited/permitted in a for-profit context.

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.

BDO Comment - Question 5

No. Variable returns is intended to be a broad concept for not-for-profit entities because these entities seldom receive financial returns.

This is illustrated in your example where Church A establishes Hospital B to provide health care services in a separate legal entity. Hospital B is advancing Church A's objectives by providing health care services and fulfilling Church A's mission by helping the sick and suffering. Therefore, the variable returns criteria for assessing control is met. However, Church A should first assess whether it has control over the relevant activities of Hospital B. In your example, Church A is only permitted to appoint three out of seven directors, so the power criterion is unlikely to be met.

We therefore do not agree with the propositions in ITC 51 that variable returns are difficult to identify in practice. In our experience, not-for-profit entities would experience more challenges assessing power over relevant activities because of the qualitative or subjective nature of the assessment, than challenges identifying variable returns.

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.

BDO Comment - Question 6

We do not think any further guidance is necessary. The concept of variable returns applies to both for-profit and not-for-profit entities and is interpreted in the broadest way. Therefore, any guidance the AASB might consider providing to not-for-profit entities would have the potential to narrow the interpretation, and this would not be consistent with how the concept is applied by for-profit entities.

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.

BDO Comment - Question 7

In your example on customary business practices, School EM establishes the Old School EM Association which is permitted to distribute proceeds of fundraising to any entity, but historically has always distributed to School EM. In this scenario, we do not consider that School EM has rights to variable returns because Old School EM Association can distribute to other entities. Therefore, it would fail the variable returns criteria, and also fails the power criteria because Old School EM Association has an independent management committee comprising seven members, only two of whom are appointed by School EM.

However, there may be instances in practice where there a School has no rights to variable returns but has exposure to variable returns because the Old School Association was established to promote the unity, welfare and advancement of past attendees of School through various services. In such cases, the power criterion must be carefully considered to assess whether School controls Old School Association.

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

8. the application of the requirements in practice?

BDO Comment - Question 8

The example provided in ITC 50 illustrates a situation whereby:

- Entity ZA establishes Company XC (a company limited by guarantee), and provides an initial investment so that Company XC can undertake a particular activity
- Company XC has an independent board of directors, of which Entity ZA can only appoint one director
- Company XC is prevented from distributing profits to items members (Entity ZA) during its life

- On winding up, Company XC must distribute surplus assets to another not-for-profit entity with similar objectives, and Entity ZA can direct Company XC as to which entity should receive these surplus assets on winding up.

Consistent with AASB10.IG17(e), we consider Entity ZA's ability to direct Company XC to distribute surplus assets on winding up (whether to themselves or another similar not-for-profit entity) to be a protective rather than a substantive right (i.e. not part of the relevant activities). Therefore, in this scenario, Entity ZA neither has:

- The power to direct the relevant activities of Company XC (it only has one board member), or
- The right to variable returns (note that it could still have exposure to variable returns through a common purpose or objectives but here there is no control without the power to direct the relevant activities).

In our view, the control assessment should not be made based upon an 'end of life' scenario. This is because we assess control in the context of the entity's relevant activities and winding up the entity is not part of the relevant activities. Power to direct the relevant activities and rights or exposure to variable returns should be determined assuming a going concern scenario. Therefore, even if it is known that a not-for-profit entity will receive proceeds on winding up of another entity, that, by itself, is insufficient to conclude that it has control over the other entity.

9. whether differences in application exist in practice?

BDO Comment - Question 9

We are not aware of differences in application in practice.

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.

BDO Comment - Question 10

We do not think additional guidance is necessary to help assess control where there is no equity interest. We consider the existing guidance contained in Appendix E to adequately address the control principles where there is no equity interest. There are many for-profit entities that control other entities in the absence of an equity interest, such as for stapling arrangements. We are concerned that additional guidance introduced for not-for-profit entities could be inconsistent with the manner in which the corresponding requirements are interpreted and applied by for-profit entities.

Regarding assessing whether an NFP in the public sector is acting as principal or an agent do you have 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?

BDO Comment - Questions 11 and 12

No. In our experience, agency arrangements in the public sector are rare.

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

BDO Comment - Question 13

We do not think additional guidance is necessary for determining whether a not-for-profit entity is acting as agent or principal as guidance is already contained in both AASB 15 and AASB 10. Adopting further guidance runs the risk of creating inconsistencies between how the same requirements are applied for for-profit and not-for-profit entities.

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

Questions

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?

BDO Comment - Question 14

No comments.

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.

BDO Comment - Question 15

We are not aware of any structured entities in the not-for-profit sector.

Topic 3 - Related party disclosures by NFP public sector entities

Questions

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

BDO Comment - Question 16

In our experience, significant judgement may be required to identify key management personnel (KMPs) and related parties in the public sector. For example, if all CFOs are considered KMPs, there may be a lot of KMPs. Public sectors need to do a lot of work to identify KMPs, obtain information about all transactions with KMPs and other related parties, and then to determine whether the information is material enough to require disclosure (a qualitative assessment is required if not quantitatively material). There are privacy issues to consider and some more distant related parties like close family may simply refuse to provide the required information/confirmation. In practice, this significant workload may produce little useful information for users, and it is difficult to audit the completeness of the information provided.

Topic 4 - Basis of preparation of special purpose financial statements - disclosures about compliance with Australian Accounting Standards

Questions

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.

BDO Comment - Question 17

No comments.