



4 April 2023

Dr Keith Kendall  
Chair  
Australian Accounting Standards Board  
PO Box 204  
Collins St West Victoria 8007  
AUSTRALIA

Dear Dr Kendall

***AASB Invitation to Comment 51 Post Implementation Review of Not-for-Profit Topics – Control, Structured Entities, Related Party Disclosures and Basis of Preparation of Special Purpose Financial Statements***

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on AASB 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* (ITC 51). The views expressed in this submission represent those of all Australian members of ACAG, unless otherwise specified.

Overall, ACAG considers that the requirements considered in ITC 51 result in financial statements that are more useful to users of not-for-profit (NFP) entity financial statements. However, ACAG considers there is benefit in the AASB providing further clarity, explanation and expanded examples in relation to the application of the control model in the NFP sector under AASB 10 *Consolidated Financial Statements*, and context and further guidance for the public sector in relation to related party disclosures under AASB 124 *Related Party Disclosures*.

The attachment to this letter addresses the AASB's request for comments on the topics outlined in ITC 51.

ACAG appreciates the opportunity to comment and trusts you find the attached comments useful.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Margaret Crawford', written in a cursive style.

Margaret Crawford  
**Chair**  
**ACAG Financial Reporting and Accounting Committee**

## AASB REQUEST FOR COMMENTS

### Topic 1 – Control and consolidation for not-for-profit (NFP) entities

#### 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?

ACAG has not encountered any significant issues with the application of the control model. However, in one jurisdiction, there have been instances of divergent views about individual entities as to whether they should be considered a subsidiary (examples are provided in the response to question 7 and 9).

#### Regarding AASB 10 Appendix E, do you have any comments about:

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

Whilst there has been some difficulty obtaining relevant information (for example, trust deeds, governance arrangements and the client's assessment), to date, this issue has been able to be addressed and the required information obtained. However, ACAG notes that, where an entity has determined that they do not control another entity, obtaining the necessary information about that entity may prove difficult for Auditors-General as such information may be outside their mandate unless it has been determined to be controlled.

One jurisdiction noted that in some instances (for example, investment entities and any entities they may control, jointly control, or have significant influence over), the difficulty experienced by the preparer may result from the number of funds to be reviewed, the associated agreements and relevant documents required to assess control, and the compilation of that information rather than in the application of the standard.

#### Regarding AASB 10 Appendix E, do you have any comments about:

3. whether differences in application exist in practice in applying the control model and Appendix E in the NFP sector?

As professional judgement is required in assessing whether control exists, ACAG considers that this sometimes results in differences in the application of the control model. However, ACAG considers the following control concepts cause the most differences in practice:

- Rights that give an investor power over an investee – there are also often differences of opinion about whether a right is substantive or protective.
- Variable returns – as this is a technical accounting term, it can be difficult for non-accountants to understand and apply which can result in an incorrect assessment of control (see also response to question 5).

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?

ACAG considers that there is scope for additional guidance in Appendix E in cases of charitable foundations, especially where the potential controlling entity does not have voting power (and/or ability to amend that voting power). Appendix B, paragraph B19, requires consideration of whether there are indications that the investor has a 'special relationship' with the investee, which suggests that the investor has more than a passive interest in the investee. As clarified in B19, the existence of any individual indicator, or a particular combination of indicators, does not necessarily mean that the power criterion is met. In practice, significant judgement is required.

Example IG2D suggests that where the board can make financial distributions to other parties there is no control (assuming the board is independent and therefore there is no power). However, it could be argued that where all monies are spent on the direct outcomes of the investor (and those outcomes are the provision of a specific event or service not otherwise made available), this is sufficient to conclude that 'a significant portion of the investee's activities either involve or are conducted on behalf of the investor' (B19(c)) and/or that the investor's rights to returns are disproportionately greater than its voting rights (B19(d)), given IG19 would be applicable in most cases.

Example IG2D does not address other inter-dependencies such as mutual websites and the use of branding. Further, in most cases, it could be argued that the composition of the board is heavily influenced by the investor, given the reputational risk to the investor and that they are often people who have a particular interest in the objectives of the investor.

ACAG also notes that some of the examples in the Implementation Guidance (IG) demonstrate extremes that are difficult to apply in practice because the reality is usually somewhere in the middle of those extremes. For example, IG1A provides an example of where an investor can control all the board members while in example IG1B they have no control over the board members. Further, IG1C provides an example of when there is no current ability to appoint board members, but the constitution can be amended to change that at any time. The conclusion is that this is sufficient to demonstrate power, but it is not clear how this aligns with IG14 where rights need to be currently exercisable.

One jurisdiction has faced similar situation as IG1C, where an entity (the investor) has the unilateral ability to amend the constitution of the Foundation (the investee) thereby having the ability to appoint the majority of the board members of the investee. However, the trust deed between the investor and the investee states that such additional board members should be independent of the investor (that is, the appointed board members must not be an employee or board member of the investor). ACAG considers it would be beneficial if the AASB can provide additional guidance or examples covering such a scenario.

ACAG also believes it would be useful if the AASB provides additional guidance and examples in the following situations where it may not always be clear if the control criteria are met:

- the government is involved in the purpose, design and establishment of the relevant entity and structures the decision making so that other parties are the primary decision makers
- where multiple parties are involved in making a decision about a relevant activity
- the government or a NFP entity appoints an entity to make decisions, but the entity can only be removed in specific circumstances
- more detail on substantive versus protective rights in the public sector context. For example, when legislation grants a Minister certain rights and powers (that appear to give the Minister the practical ability to exercise substantive rights), however it is asserted that the intention is that the Minister will only exercise these rights and powers in a protective manner.

5. Do you have any comments about difficulties that might be experienced in identifying variable returns in the NFP sector?

ACAG notes that some of the difficulties in identifying variable returns in the NFP sector relate to determining the difference between similar/congruent objectives and non-financial returns or furthering the objectives of the investor and achieving social policy objectives. For example, in the public sector, some entities established by Acts and Ministers are responsible for administering those Acts. Often the entities created will have functions that serve the public but may also help fulfil the Minister's or the department's objectives under an Act. Judgement is required to determine whether the entity established is furthering the objectives of the Minister and department or whether they only have congruent objectives.

ACAG also notes that 'variable returns' is an accounting technical term that does not translate easily in practice. It is difficult, for example, for a non-accountant board member to understand and apply the term, which can result in an incorrect assessment of control.

ACAG believes it would be useful if the AASB provides additional guidance and examples in applying variable returns in the public sector environment, particularly in relation to non-financial 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?

ACAG suggests that the AASB provide more examples in applying variable returns in the public sector environment, particularly in relation to non-financial returns.

7. Do you have any comments regarding customary business practices in the NFP sector?

ACAG has found that this issue mainly relates to the fundraising arms of organisations. These fundraising arms are often set-up by like-minded people, such as 'friends of'. It is common that the distribution by the fundraising entity is not restricted by its constitution to the one entity, though the funds raised (based on customary business practices) are paid to the one entity.

Given the guidance in AASB 10 (specifically in Illustrative Example IG2D) in relation to the need to have power over the decision making of the fundraising entity (for example, the appointment of directors), such entities are often not consolidated except for situations similar to IG1C.

While we have seen consistent application with the guidance, there are often questions whether the customary business practice of distributing all funds to the investor should result in the investor having control over the fundraising entity.

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

8. the application of the requirements in practice?

When State and local governments or related bodies fund activities, it is common for them to have some involvement in how that money is spent. Often, the involvement is restricted to a single project or funding agreement, but in some cases, an entity is set-up to undertake a narrow range of activities.

Regarding the latter, where the entity's activities align with the State or local government body, it can be difficult to determine whether the State or local government body is exposed to the variable returns (outcomes of those activities) and whether it has power over those variable returns.

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

9. whether differences in application exist in practice?

It is often difficult to apply the power over variable returns test when there is an alignment of values and outcomes (and non-financial returns) between the State or local government body initiating the establishment of the entity, and the desire to 'be involved'. Being involved often involves some sort of review or approval of budgets and plans. While some situations can be relatively easily categorised into protective, and participative, others are much more difficult when the involvement extends to detailed operating parameters, such as decisions over services to be provided, performance expectations and points of presence.

The following examples illustrate the difficulty of applying the control criteria in practice to determine whether the entity was controlled.

*Example 1 – Is the Responsible Organisation controlled by the government?*

The government, via state legislation, sets up an industry-based scheme to be run by a Responsible Organisation (RO), an entity registered under another jurisdiction (federal). It is anticipated that the RO will be self-funding and will not require government funding, though an initial loan to be repaid in the near future has been provided.

The government establishes a levy system to assist in funding the RO and determines the levy rate, and the items the levy applies to. Industry participants provide some initial funding, to be repaid from surpluses.

The scheme is not-for-profit, and any operating surplus is reinvested to aid continual improvement and ensure the delivery of an effective and efficient scheme.

The relevant Act specifies the RO's functions, and the RO must comply with any written direction given by the Minister about the performance of the functions or exercise of the powers necessary for performing its functions.

Other relevant facts include the:

- RO's strategic plan must be approved by the Minister
- Department / Minister does not control the appointment of directors
- Government sets the minimum recovery rate
- Government sets the minimum number of points of presence
- Directors determine, subject to the strategic plan being approved by the Minister and other matters above, how it achieves the recovery rate, operates the points of presence, and earns a surplus.

*Example 2 – Is the service entity controlled by the department?*

The government, via state legislation, sets up statutory bodies, separated into regions to provide designated public services. The department determines the services to be provided including which are added and which are removed, as well as the funding amounts. The department can also differentiate from statutory body to statutory body for the same service.

The department requires a statutory body to use departmental staff, which allows for the transfer of staff between statutory bodies and the retention of benefits. The statutory bodies decide how to achieve the provision of services and the achievement of results.

The Minister (not the department) effectively appoints board members of statutory bodies.

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?

ACAG believes it would be beneficial if the AASB explained further how the alignment of values and outcomes (and non-financial returns) is applied in the public sector.

**Regarding assessing whether a 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?

ACAG does not have any comments about distinguishing the role of an entity in practice, but notes that this issue mainly arises in relation to individual agreements rather than the control of an entity as a whole.

ACAG makes specific principal versus agent comments regarding the transfer of funds received to other entities including the appropriate recognition of financial liabilities (Topic 4) in its submission on ITC 50 *Post Implementation Review – Income of Not-for-Profit Entities*.

**Regarding assessing whether a NFP entity in the public sector is acting as principal or an agent do you have any comments about:**

12. whether differences in application exist in practice when applying the control model and Appendix E?

ACAG is not aware of any differences in practice regarding assessing principal versus agent when applying the control model to a NFP entity.

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?

ACAG does not consider that any further guidance is required.

### **Topic 2 – The definition of a structured entity for NFP entities**

**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?

ACAG does not have any comments on the application of the requirements in practice.

**Regarding the definition of a structured entity in the NFP sector and the guidance in Appendix E, do you have any comments about:**

15. any other matters of which the AASB should be aware as it undertakes this PIR?

ACAG does not have any comments on any other matters that it considers the AASB should be aware of in undertaking this PIR.

### **Topic 3 – Related party disclosures by NFP public sector entities**

16. Do you have any comments regarding the disclosure of related party information by NFP public sector entities?

ACAG agrees that the disclosure of related party information is important, but presents some challenges in identifying a complete set of related parties and in collecting, verifying, and ensuring the completeness of representations made by related parties.

For example, when obtaining Minister and Councillor disclosures, there is a tendency to rely on Ministerial or Councillor disclosures which may not provide the level of detail required. Obtaining assurance over the completeness of this information is inherently challenging and generally requires additional audit effort. In these circumstances, it is difficult to ascertain whether the cause of incomplete disclosures is because of a lack of awareness or understanding of the requirements of the standard or whether there is an unwillingness to disclose.

ACAG also agrees that there are challenges because of the close family member provisions of the standard. For example, obtaining responses from key management personnel in relation to minors due to privacy concerns and the application of the 'close family member' concept, which in some cultures may be considered a very large group of people. For example, the guidance does not sufficiently cover the application of 'Close members of the family' to Aboriginal or Torres Strait Islanders. For example, the government is proposing changes to the Family Law Act 1975 to expand the definition of relative to a child to include "for an Aboriginal child or Torres Strait Islander child— a person who, in accordance with the child's Aboriginal or Torres Strait Islander culture, is related to the child".

ACAG believes that further guidance on 'close family members' could be provided to the address the above.

ACAG considers that there would be benefit in the AASB providing context for related party disclosures in the public sector. One jurisdiction questions the relevance of related party disclosures for public sector entities in relation to transactions between government entities as per AASB 124.26. In the private sector, the standard was introduced to draw attention to the possibility that an entity's financial position and profit or loss may have been affected by the existence of related parties. This jurisdiction believes in the public sector, there is no risk to the bottom line and if the transactions are on a non-commercial basis such as giving a non-reciprocal grant, then the transaction is obvious.

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

17. Do you have any comments regarding the SPFS disclosures regarding compliance with Australian Accounting Standards by NFP private sector entities?

ACAG considers that these requirements could be extended to public sector SPFS.

**AASB General Matters for Comment**

18. Does the application of the requirements considered in this ITC adversely affect any regulatory requirements for NFP entities?

ACAG does not consider that 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?

ACAG considers the assessment of control, and the audit of related party disclosures result in auditing and assurance challenges.

In relation to control, the challenges mainly relate to when there is a significant level of judgement involved in determining whether an entity has control, especially when there are only non-financial returns.

For the audit of related parties, they key challenge is ensuring the completeness of representations made by related parties.

20. Overall, do the requirements considered in this ITC result in financial statements that are more useful to users of NFP entity financial statements?

ACAG considers that, overall, 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?

ACAG considers that 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?

ACAG does not have any other matters that it would like to bring the attention of the AASB.