



Project:	Post-Implementation Reviews	Meeting:	M187
Topic:	NFP domestic PIRs	Agenda Item:	4.1
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Project Priority:	Medium
Decision-Making:	Low
Project Status:	Initial deliberations

Objective of this paper

- 1 This staff paper considers the not-for-profit (NFP) specific requirements relating to control and the application of the definition of a structured entity. The objective of this staff paper is to:
 - (a) refresh the Board on the key reasons why the requirements were issued;
 - (b) refresh the Board about the Board’s due process before issuing the requirements; and
 - (c) provide the Board with a summary of known issues arising from the implementation and application of the requirements.

Background

- 2 At its 8-9 September 2021 meeting, the Board considered a proposed post-implementation review (PIR) process and a strategy for undertaking PIRs on the domestic Australian Accounting Standards, including Interpretations¹ on issue.
- 3 The Board agreed to progress its PIR work in tranches over the 2021-2025 period. It concurred with the staff recommendation that its first tranche of PIR work (the ‘Category 1 PIRs’) should primarily comprise the review of topics that could be expected to inform the Board’s decision making on its NFP Private Sector Financial Reporting Framework project (the ‘NFP domestic PIRs’).
- 4 The NFP domestic PIRs consider Standards addressing the topics of:
 - (a) income;
 - (b) control/consolidation;
 - (c) the definition of a structured entity;
 - (d) related party disclosures; and
 - (e) SPFS basis of accounting – compliance with Australian Accounting Standards.
- 5 The Board considered the topics of related party disclosures and SPFS basis of accounting – compliance with Australian Accounting Standards at the May 2022 meeting. At this same meeting, the Board also received an update on the preliminary findings from the literature

1 For the purposes of the PIR, “domestic” references both a Standard issued as AASB 10XX and NFP amendments, including guidance, to the suite of Standards that incorporate IFRSs.

review. This paper continues the Board's PIR discussions, as set out in the timeline reviewed by the Board at its May 2022 meeting.

Structure of this paper

- 6 The remainder of this paper provides the Board with a:
 - (a) high-level overview of AASB 10 *Consolidated Financial Statements* Appendix E (paragraphs 8 – 43);
 - (b) high-level overview of AASB 12 *Disclosure of Interests in Associates and Joint Ventures* Appendix E (paragraphs 44 – 56); and
 - (c) project timeline and next steps (paragraph 57).
- 7 The high-level overview of the requirements:
 - (a) describes the Board's rationale for issuing the requirements;
 - (b) summarises the key requirements of the appendices;
 - (c) summarises implementation and application issues staff are aware of; and
 - (d) the Board's due process in developing each of the appendices.

High-level overview: Control/consolidation

Board's rationale for guidance for NFP entities on determining when an entity controls another

- 8 AASB 10 was first issued by the Board in August 2011. It was to be effective for annual reporting periods beginning on or after 1 January 2013.
- 9 AASB 10 was one of a suite of new consolidation standards issued in Australia. The suite included AASB 10, AASB 11 *Joint Arrangements*, AASB 12, revised AASB 127 *Separate Financial Statements* and revised AASB 128 *Investments in Associates and Joint Ventures*.
- 10 When AASB 10 was issued, the Board prevented NFP entities from early adopting the requirements before the 1 January 2013 mandatory application date. In December 2012, the Board further deferred the NFP mandatory application date of AASB 10 to 1 January 2014. This deferral provided time for the Board to complete its consideration of NFP-specific issues associated with AASB 10 and the other newly issued Standards in the suite.
- 11 In October 2013, the Board added Appendix E to AASB 10 (via AASB 2013-8 *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Entities – Control and Structured Entities*). Appendix E explains various principles in AASB 10 from the perspective of NFP entities, including the criteria for determining whether one entity controls another entity, and illustrates the principles with examples.
- 12 AASB 10 paragraph 6 states that "An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and can affect those returns through its power over the investee."
- 13 AASB 10 paragraph 7 states that for an investor to control an investee, the following three 'control' criteria must be present: power over the investee, returns to the investor, and the link between power and returns.
- 14 Appendix E does not seek to replace or revise the terminology used in AASB 10 but explains its application in the NFP private and public sectors. Appendix E also does not amend or deviate from the principles underlying AASB 10.

Key guidance included in the Standard

- 15 The objective of AASB 10 is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.
- 16 Specifically, AASB 10:
- (a) requires an entity (the parent) that controls one or more other entities (subsidiaries) to present consolidated financial statements;
 - (b) defines the principle of control, and establishes control as the basis for consolidation;
 - (c) sets out how to apply the principle of control to identify whether an investor controls an investee and, therefore, must consolidate the investee;
 - (d) sets out the accounting requirements for the preparation of consolidated financial statements; and
 - (e) defines an investment entity and sets out an exception to consolidating particular subsidiaries of an investment entity.
- 17 As AASB 10 is equivalent to IFRS 10 *Consolidated Financial Statements*, it is drafted from a for-profit perspective. Therefore, at a high-level Appendix E sets out guidance that addresses the following for NFP entities:
- (a) the circumstances when rights arising from statutory arrangements may give rise to power;
 - (b) what affect, if any, economic dependence and power over the composition of the board has on the control assessment;
 - (c) guidance on substantive and protective rights and whether regulatory powers and statutory arrangements would be considered protective or substantive in nature;
 - (d) the requirement to apply the general control principles contained within AASB 10 when assessing whether State or Territory governments control local governments and whether governments control Universities;
 - (e) what affect the role of management/the board, together with the nature of returns received, or a trust established by a for-profit charity, has on the control conclusion;
 - (f) what constitutes a return and whether congruent objectives is sufficient to conclude whether a NFP investor controls an investee (assuming the other elements of the control model (i.e. power and the link between power and returns) are present); and
 - (g) the concept of delegated power and what principles to apply when determining whether a NFP investor is a principal or an agent.
- 18 When finalising AASB 2013-8, the Basis for Conclusions noted that some of the issues identified during the Board's due process were fundamental to the notion of control and were beyond the scope of AASB 10. These issues included:
- (a) the nature of government departments as reporting entities;
 - (b) the role that disclosure of disaggregated information in whole of government financial reports might play in providing relevant information to users; and
 - (c) control of assets.
- 19 At the time, the Board concluded that because these issues are beyond the scope of AASB 10 and would not impede the application of AASB 10 by NFP entities, these issues did not need to be addressed before clarifying the application of the notion of control in AASB 10 for NFP entities. For the same reasons, staff consider that these issues are beyond the scope of this PIR

topic. However, staff suggest that the Board consider them as part of its forthcoming PIR of certain public sector Standards².

Implementation issues

NFP private sector

Outcome of applying the control model

- 20 Feedback from staff of federal, state and territory regulators and NFP Project Advisory Panel members before and during the Board's current NFP Financial Reporting Framework project suggests that some stakeholders have concerns about applying the control model in the NFP private sector. Specifically, that AASB 10 requires entities to consolidate other entities they do not believe they have 'true' control over (that is, where the parent has 'theoretical' control through constitutional requirements rather than an in-practice exercise of control). Staff of one regulator observed that many NFP entity organisational structures do not naturally fit into AASB 10's "control" definition. Some NFP Project Advisory Panel members also indicated that preparers and auditors might disagree with some of the control conclusions illustrated in Appendix E of AASB 10.³
- 21 While some NFP entities operate as independent legal entities, others carry out their activities in conjunction with one or more related entities. For example, fundraising is often conducted by legally separate foundations or funds. Schools might have related entities engaged in investing or real estate management. When such relationships meet the control criteria in AASB 10, the financial position and performance of all entities must be aggregated, and consolidated financial statements must be prepared.
- 22 Staff understand that the governance structure of some religious organisations or schools may imply that one entity controls another. However, some stakeholders disagree with this conclusion. In their view, whilst there might be a relationship and shared objectives between one NFP entity and another (say a school and its building fund or a church and an auxiliary organisation), consolidation is not always appropriate. In their view, consolidation can be problematic, particularly if there is no shared financial liability or other financial impact of the relationship (e.g. a school cannot access assets held by the building fund to meet its operational or day-to-day commitments).
- 23 Stakeholders are concerned that if a school consolidates the building fund, for example, the school's financial position and performance may be obscured by the assets of the building fund, which the school cannot access to meet its operational or day-to-day needs. Stakeholders suggest that this may place donations and grants at risk if the school appears to be in a 'better' financial position than it is. Some stakeholders also suggest that preparing consolidated financial statements may not meet users' needs if users seek to understand the school's financial position and performance.

Ability to gather information

- 24 As part of the Board's current NFP Financial Reporting Framework project, staff received feedback from a NFP Project Advisory Panel member that NFP entities may face difficulty in

2 This PIR includes AASB 1050 *Administered Items*, AASB 1051 *Land Under Roads*, AASB 1052 *Disaggregated Disclosures*, AASB 1004 *Contributions* and Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities*.

3 Feedback pertaining to control/consolidation gathered as part of the Board's current NFP Financial Reporting Framework project was reported to the Board in [Agenda Paper 3.3](#) and Agenda Paper 3.4 of the AASB June 2021 meeting.

identifying and consolidating a controlled entity because the information is not available to the entity due to practices in the sector (e.g. secrecy and a lack of documentation).⁴

Assessing control without an ownership interest

- 25 Staff understand that assessing whether a NFP entity has rights that give rise to power can be challenging due to the legal structure of some entities. For example, companies limited by guarantee (CLBG) are often prohibited by their constitution from making distributions to their members. Instead, the constitution commonly requires any surplus assets be distributed to a like-minded entity.
- 26 Where an entity (investor) establishes a CLBG (investee) and provides it with the funds necessary to undertake a particular activity, if the investor can control how the CLBG must distribute any surplus assets on winding up of the investee, this is likely to indicate that the investor has an exposure to variable returns. This can be the case even if the investor itself is not entitled to the distribution.
- 27 However, because Appendix E paragraph 17(e) suggests that the right to direct distributions on winding up may be considered a protective right rather than a substantive right, the investor may not be considered to have control over the investee.
- 28 In practice, staff understand that when surplus assets are distributed back to the investor, investors often conclude that they have control. Conversely, when surplus assets are distributed to an unrelated entity, determining whether or not the investor has control is less clear, and divergence in practice has emerged. In some cases, investors conclude they have control, whereas, in others, they do not.
- 29 In addition to assessing control, staff are aware that mergers in the NFP sector often occur without the transfer of consideration. Instead, they occur via contract alone. Typically, one entity (the parent) will acquire the net assets of another entity (the subsidiary) without transferring any consideration or equity instruments. When accounting for these transactions, the parent entity recognises the subsidiary's net assets (a debit entry) in the consolidated financial statements. However, staff understand that divergence has emerged regarding where the credit entry should be recognised.
- 30 Staff understand that some parent entities recognise the credit in equity, while others recognise the credit in the profit or loss.
- 31 Staff note that AASB 3 *Business Combinations* paragraph 44 sets out that if a business combination is achieved by contract alone, the acquirer shall attribute to the owners of the acquiree the amount of the acquiree's net assets recognised in accordance with AASB 3. Essentially this means that the equity interests held in the acquiree by parties other than the acquirer are shown as a non-controlling interest (NCI). This is the case even if all of the equity interests in the acquiree are shown as a NCI. Staff understand that some stakeholders prefer this treatment as it removes any 'lumpiness' from the profit or loss in the year the merger occurs.
- 32 Conversely, staff note that generally, in the NFP sector, when a NFP acquires 'something' for significantly less than fair value principally to enable the NFP entity to further its objectives, the asset is recognised at fair value, and the credit entry is often recognised in the profit or loss. As the merger is a business combination, it is outside the scope of AASB 1058 *Income of Not-for-Profit Entities* (paragraph 7(b)). However, staff understand that some stakeholders

4 Feedback relating to control/consolidation gathered as part of the Board's current NFP Financial Reporting Framework project was reported to the Board in [Agenda Paper 3.3](#) and Agenda Paper 3.4 of the AASB June 2021 meeting.

apply AASB 1058 by analogy and recognise the credit entry in the profit or loss, akin to the accounting treatment for donated assets.

- 33 Staff note that the issue summarised in paragraphs 29 – 32 is beyond the scope of this PIR topic as it does not relate to determining whether an entity is controlled and rather the resulting accounting treatment of a controlled entity. However, staff suggest this issue should be considered as part of the Business Combinations under Common Control project.

NFP public sector

- 34 In response to AASB ITC 43 *Request for Comment on IASB Request for Information on Post-implementation Review – IFRS 10, 11 and 12*, the Board received a submission from Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC). HoTARAC did not have any issues with IFRS 10 and IFRS 11 that it wished to bring to the Board’s attention. However, the submission noted that “the additional guidance previously added to the Australian standard (AASB 10) has been useful in clarifying practical issues of control”.^{5,6}

Principal v agent

- 35 As part of the feedback on ED 318 *Illustrative Examples for Income of Not-for-Profit Entities and Right-of-Use Assets*, stakeholders sought clarification of when an entity might be acting as a principal versus as an agent.⁷ Staff are also aware of situations in the public sector where it is unclear whether or not a party is an agent. In the public sector, investments are often not financial, and returns are quite often in the form of policy outcomes rather than financial outcomes. The difficulties applying the guidance could be due to the nature of the public sector relationships and may not be equally relevant in the private sector. Feedback to AASB staff noted that there appeared to be inconsistent conclusions in similar situations. It has been suggested that the existing guidance in AASB 10 Appendix E is generally useful as it clarifies/ confirms how to analogise the requirements for the public sector. However, in some cases, it was necessary to apply the for-profit guidance that applies to managed funds. This was challenging for finance professionals who do not have a background within the finance sector.⁸

Process in developing AASB 10 Appendix E

- 36 AASB 10 incorporates IFRS 10. Consequently, the text of the body of AASB 10 and Appendices A–C is expressed from the perspective of for-profit entities in the private sector.

The due process in developing AASB 2013-8

- 37 The AASB issued Exposure Draft ED 238 *Consolidated Financial Statements – Australian Implementation Guidance for Not-for-Profit Entities* to propose adding an appendix to AASB 10 to explain and illustrate how the principles in AASB 10 apply from the perspective of NFP entities in the private and public sectors, particularly to address circumstances where a for-profit perspective does not readily translate to a NFP perspective.
- 38 In developing the proposals in ED 238, discussions were held with constituents experienced in NFP public sector and private sector financial reporting to identify implementation issues that might be encountered in applying AASB 10 in a NFP context. The Board also commissioned research into the implementation issues encountered by NFP entities applying the notion of

5 [HoTARAC submission](#) on AASB ITC 43.

6 Staff acknowledge that the HoTARAC submission provided feedback regarding the level of disclosures required by IFRS 12./ This feedback was included in the AASB’s response to the IASB on the PIR of IFRS 10, IFRS 11 and IFRS 12.

7 Refer [Agenda Paper 5.1](#) of the AASB April 2022 meeting.

8 This feedback was obtained from a PAP member during the AASB’s outreach as part of the IFRS 10, IFRS 11 and IFRS 12 PIR.

control in the superseded AASB 127 *Consolidated and Separate Financial Statements*. At the time, an extensive search of the academic and professional literature in accounting was undertaken. It did not identify any significant discussion of the issue of the application of control in the NFP sector.⁹

- 39 ED 238 was issued for public comment in March 2013, with comments due by 30 June 2013. The Board received thirteen submissions. Most were generally supportive of the proposals whilst raising various issues for the Board's consideration.
- 40 The Board finalised AASB 10 Appendix E in October 2013.

Stakeholder concerns during the development of AASB 10 Appendix E

- 41 In finalising AASB 10 Appendix E, the Board considered feedback from stakeholders and made several changes to the ED 238 proposals. For example, the Board:
- (a) amended major examples to more clearly address the relevant activities of the NFP entity and to more clearly address the three criteria for control;
 - (b) included an additional NFP private sector example following feedback that the examples were too focussed on NPF public sector entities;
 - (c) amended guidance to acknowledge that in limited circumstances, rights under substantively enacted legislation could become exercisable in time for making decisions about an investee's relevant activities; and
 - (d) clarifying that a delegate in the NFP public sector is not an agent of the delegator. References to 'delegated control' were also deleted as it was unnecessary to introduce a new term.
- 42 The Board also discussed a range of other issues raised by respondents. These issues included:
- (a) considering whether to provide guidance about assessing the relative significance of the rights of different parties (i.e. identifying which investor directs the activities that most significantly affect the investee's returns);
 - (b) including an alternative local government scenario when assessing control for completeness;
 - (c) considering whether to extend a proposed example to address collective control under which a particular entity would be consolidated in the whole of government financial statements despite no individual entity or Minister in the jurisdiction being considered to control the particular entity; and
 - (d) providing guidance on the effect of removal rights in the public sector since a government or Minister will often have the right to dismiss key executives of public sector entities such as department heads; and
 - (e) reconsidering the position that the power to enact or change legislation could not give an investor the current ability to direct the relevant activities of an investee.
- 43 The Board considered the matters summarised in para 42. However, no changes were made to the implementation guidance proposed in ED 238 when the Board finalised AASB 10 Appendix E.

Question for Board members

Q1 Do Board members have any comments on the high-level summary of AASB 10 Appendix E?

⁹ Staff's consideration of this research and its relevance to this PIR topic is on-going.

High-level overview: Structured Entities

Board's rationale for issuing guidance on the application of the definition of 'structured entities' for NFP entities

- 44 As noted in paragraph 9, AASB 12 was first issued by the Board in August 2011. Like AASB 10, it was to be effective for annual reporting periods beginning on or after 1 January 2013. However, when AASB 12 was issued, the Board also prevented NFP entities from early adopting the requirements before the 1 January 2013 mandatory application date.
- 45 In October 2013, the Board further deferred the NFP mandatory application date to 1 January 2014, as it did with AASB 10, so the Board could consider NFP-specific issues associated with the other newly issued Standards in the suite.
- 46 In October 2013, the Board added Appendix E to AASB 12 (via AASB 2013-8). Appendix E explains the application of the definition of 'structured entity' by NFP entities.

Key guidance included in AASB12 Appendix E

- 47 AASB 12 contains specific disclosure requirements for consolidated and unconsolidated structured entities. A structured entity is defined in AASB 12 Appendix A as "an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements."
- 48 For many NFP entities, voting rights may not be the dominant factor in deciding who controls an entity. Accordingly, the application of the structured entity definition would result in many NFP entities being classified as structured entities due to the absence of voting or similar rights.
- 49 AASB 12 Appendix E provides guidance that explains that the principle underlying the definition of a structured entity is intended to capture entities where less conventional means are the dominant factors in determining who controls the entity and that structured entities are intended to be a limited class of entities.
- 50 The guidance in Appendix E stipulates that the reference in the definition of a structured entity to 'similar rights' includes administrative arrangements and statutory provisions, as these are often the dominant factor in determining control of NFP entities.
- 51 Therefore, NFP entities designed so that voting rights, including administrative arrangements or statutory provisions, are not the dominant factor in determining control of an entity would not be captured by the definition of structured entity in AASB 12.

Implementation issues

- 52 At the time of writing this paper, staff are not aware of any implementation issues with applying AASB 12 Appendix E by NFP entities.

Process in developing AASB 12 Appendix E

- 53 Like AASB 10, the AASB issued ED 238 to propose adding an appendix to AASB 12 to explain how to apply the definition of structured entity by NFP entities.
- 54 As noted in paragraph 38, in developing the proposals in ED 238, discussions were held with constituents experienced in NFP public sector and private sector financial reporting.
- 55 Following the issue of ED 238, the Board considered the thirteen submissions that were received and finalised AASB 12 Appendix E in October 2013. In finalising AASB 12 Appendix E, limited amendments were made to the proposals in ED 238.

Stakeholder concerns made during the development of AASB 12 Appendix E

56 Staff are not aware of any specific implementation issues with the requirements.

Question for Board members

Q2 Do Board members have any comments on the high-level summary of AASB 12 Appendix E?

Project timeline and next steps

57 The following table contains the revised NFP domestic PIR timeline agreed upon with the Board at the May 2022 Board meeting. Subject to any feedback from Board members, staff intend to continue progressing work on the NFP domestic PIR project as outlined in the timeline below.

Staff's proposed timeline	Project milestones based on the PIR process
<i>Control/ consolidation and structured entities</i> Board meeting: 22/23 June 2022	Steps 1, 2: Review of original project documentation and collation of identified issues.
June 2022	Step 3: Finalise findings from academic research
June 2022 – September 2022: <i>all topics except for income</i>	Step 4: Seek preliminary feedback from targeted stakeholders (as necessary) and review feedback received ¹⁰
<i>Income</i> Board meeting: 3 August 2022	Steps 1, 2: Review of original project documentation and collation of issues the Board are aware of.
Board meeting: 21/22 September 2022	Steps 5, 6: Prioritise issues identified in the planning phase to determine the scope of the consultation document and discuss steps 1–5 (as necessary) with the Board before developing the consultation document. Staff note that prior to the September 2022 meeting, the Board will have considered steps 1 and 2 for each of the topics covered by the NFP domestic PIRs. Therefore, discussion at the September meeting is expected to be limited to providing Board members with an update on any findings from academic and relevant non-academic research, feedback obtained from stakeholders during targeted outreach and any sweep issues.
	Step 7: Draft consultation document.

¹⁰ As staff have previously gathered initial feedback from targeted stakeholders relating to income of NFP entities as part of the Board's narrow-scope project on this topic, no additional targeted outreach is considered necessary.

Staff's proposed timeline	Project milestones based on the PIR process
September 2022 – October 2022	<p>Step 8: Discuss draft consultation document with the Board and approve for issue.</p> <p>Staff intend to ask the Board to approve the consultation document out-of-session either via the full Board or a subcommittee.</p> <p>Staff propose a comment period of approximately 150-days to align with the expected comment period for the NFP Private Sector Financial Reporting Framework Tier 3 Discussion Paper.</p> <p>Comments on this consultation paper are expected to close end of March 2023.</p>
December 2022 – March 2023	<p>Step 9: Undertake general and targeted outreach to seek stakeholder feedback on the consultation document.</p>
Q2 2023 – Q3 2023	<p>Step 10: Consultation comment period closes at the end of March 2023 (the original timeline has a planned comment period closing in Q1 2023).</p> <p>Step 11: Review and summarise responses received on the consultation document and through outreach. Perform follow-up procedures where appropriate.</p> <p>Step 12: Identify possible 'next steps' to respond to findings.</p> <p>Step 13: Discuss feedback and possible next steps with the Board.</p>
Q4 2023	<p>Step 14: Prepare a feedback statement, discuss it with the Board and publish the feedback statement.</p>

Question for Board members

Q3 Do Board members have any comments on the project timeline?