

XX September 2008

Sir David Tweedie
International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
UNITED KINGDOM

Dear David

Discussion Paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity*

The Australian Accounting Standards Board (AASB) is pleased to provide comments on the abovenamed Discussion Paper. In forming its views on the Discussion Paper, the AASB held a Roundtable with constituents and considered comments it received in response to its Invitation to Comment on the Discussion Paper.

The AASB generally supports the proposed concepts for private sector businesses. It also supports a notion of a reporting entity that is broader than a legal entity and particularly supports the entity approach to preparing consolidated financial statements.

The AASB's comments on specific aspects of those proposed concepts are in the attached submission.

Primary comments about proposals

The AASB's primary comments for including the proposed concepts as an additional chapter in the revised *Framework* are:

- (a) The reporting entity should be defined. The definition should not identify a reporting entity on the basis of parties with a casual interest in the entity's activities, rather the identification of entities that should prepare general purpose financial reports should depend on the identified objectives of financial reporting. The definition should have a generic reference to 'users' who depend on the general purpose financial reports of the reporting entity for making resource allocation decisions.
- (b) The reporting entity chapter of the Framework should recognise the complementary role of 'risks and rewards' in determining who controls an entity.
- (c) There should be a balanced discussion of both the aggregation and disaggregation issues.
- (d) The benefit criterion in the working definition of control should be further explained, and expanded to cover forms other than cash flows.

- (e) The determination of the boundaries of a reporting entity under the common control model should further be addressed.
- (f) There should be an explicit statement in the Framework that references to consolidated financial statements do not necessarily imply a line-by-line consolidation of the controlled entity and that the accounting consequences of there being a controlled entity is a standards-level issue.

Implications for not-for-profit entities

The Appendix to the submission provides the AASB's comments on potential implications of the proposed concepts for not-for-profit entities. These comments are principally provided for Phase G of the Framework project. In addition, the AASB considers it might be useful for the IASB and FASB to be aware of these implications, especially to identify opportunities to use concepts and terminology that are sufficiently broad to apply to private sector businesses and other types of entity.

Suggestion for using more neutral expression

Because the AASB is responsible for developing a conceptual framework applicable to all Australian reporting entities, regardless of the sector in which those entities operate, its approach has been to add to the IASB *Framework* text for entities not addressed by that *Framework*, but only to the extent necessary. It would assist the AASB and other national standard setters adopting the IASB *Framework* if the expressions used in the revised IASB *Framework* were as sector-neutral as possible.

If you have queries regarding any matters in this submission, please contact Ahmad Hamidi (ahamidi@asb.gov.au) or myself.

Yours sincerely

David Boymal
Chairman

Preliminary Views on an improved Conceptual Framework for Financial Reporting: *The Reporting Entity*

Specific Comments in Relation to Private Sector Businesses

Section 1: The reporting entity concept

Question 1

Do you agree that what constitutes a reporting entity should not be limited to business activities that are structured as legal entities? If not, why?

1. The AASB supports having a notion of a reporting entity that is broader than activities that are structured as legal entities because users may have a need for information about a business that is not defined by legal boundaries.
2. A limitation on reporting entities being legal entities would also be particularly inappropriate in the not-for-profit sector where entities about which there is significant user interest and demand for accountability may not have a legal status. Australia applies the IASB conceptual framework with limited modifications for not-for-profit entities. Accordingly, the Discussion Paper's approach would be helpful in maintaining this approach when revising the current domestic Framework based on the outcome of the IASB-FASB conceptual framework project.

Question 2

Do you agree that the conceptual framework should broadly describe (rather than precisely define) a reporting entity as a circumscribed area of business activity of interest to present and potential equity investors, lenders and other capital providers? If not, why? For example, do you believe that the conceptual framework should establish a precise definition of a reporting entity? If so, how would you define the term? Do you disagree with including reference to equity investors, lenders and other capital providers in the description (or definition) of a reporting entity? If so, why?

3. The AASB believes there is a need for a generic definition of a reporting entity at the global level. The Australian Statement of Accounting Concepts (SAC 1) *Definition of the Reporting Entity* utilises this approach and the Australian financial reporting has relied on SAC 1's definition over the past 16 years. A generic definition of a reporting entity is supported for the following reasons.
 - (a) describing the reporting entity in a broad manner, rather than defining it, does not provide leadership for individual jurisdictions on this issue. A definition that reflects the characteristics of a reporting entity can provide a conceptual basis for informed legislative decisions at a jurisdictional level;
 - (b) at the jurisdictional level, where the legislation is silent or the national standard setter does not provide a definition, the absence of an IASB definition will make it difficult for preparers, auditors and regulators to determine whether the entity is a reporting entity;
 - (c) while, it may be argued that a strength of a broad description is that it helps overcome manipulation, for example, through structures that facilitate off-balance sheet items, a broad description may also capture disaggregated units

that otherwise are not intended to be the subject matter of general purpose financial reports. The notion of ‘a circumscribed area of business activity’ is too vague and difficult to apply. For example, it may lead to a segment being incorrectly classified as a reporting entity; and

- (d) the Discussion Paper (DP) effectively states that an entity cannot be a reporting entity and not prepare a general purpose financial report. The DP focuses on entities that cannot be reporting entities rather than entities that should be reporting entities. The AASB considers that it would be preferable for the focus to be on the positive, that is those entities that should be reporting entities.
4. The AASB does not believe that identifying the characteristics of a reporting entity could preclude entities without those characteristics from preparing general purpose financial reports, in the same manner that defining ‘publicly accountable’ entity under the IFRS for Private Entities project need not deter a non-publicly accountable entity from choosing to apply full IFRSs.
 5. The AASB notes that the proposed description of a reporting entity relies on the notion of ‘capital provider’. This notion depicts a narrow spectrum of users and should be expanded for the following reasons:
 - (a) the notion is market-oriented and of less relevance to developing countries. It may only work well in environments where capital markets are a dominant feature;
 - (b) the term ‘capital provider’ does not cover public interest. While it is up to the standard setter in each jurisdiction to assess public interest, it would be appropriate to acknowledge ‘public interest’ in the IASB’s conceptual framework by identifying a broader range of users in the Objectives phase of the conceptual framework project. The definition of a reporting entity would subsequently include a reference to this broader range of users;
 - (c) the term ‘business activity’ in the description of a reporting entity should be replaced with a term that is more generic. Throughout the DP, the analysis appears to have been made with only the for-profit private entities in mind and this creates ambiguities as to the breadth of activities the term is meant to cover;
 - (d) the DP does not clarify why ‘business’ is a building block of the proposed reporting entity concept. Although ‘business’ has a specific defined meaning in IFRS 3, this might not have been the intended meaning at a conceptual level. The term ‘business’ can have different connotations in different contexts and may need to be defined or clarified. For example, some note, it is not clear whether Special Purpose Entities (SPEs) would constitute businesses;
 - (e) paragraph 26 of the DP notes that some might have concerns about specifically referring to ‘capital providers’ in the description of a reporting entity since it may imply that the existence of the circumscribed area of business activity depends on there being capital providers who have an interest in the business. Although we do not have the concern noted, the DP’s argument that the business exists irrespective of there being capital providers who have an interest seems unconvincing; and

- (f) while the existence of a legal entity is the natural start to the discussion about reporting entity, the circumstances in which aggregation and disaggregation should be required needs to be considered. More discussion is needed in the DP on disaggregation such as the circumstances in which branches and similar units could be reporting entities.
6. The Australian Statements of Accounting Concepts (SAC) 2 *Objective of General Purpose Financial Reporting* notes that general purpose financial reports shall provide information useful to users for making and evaluating decisions about the allocation of scarce resources. The definition of a reporting entity in SAC 1 has regard to those users who intend to rely on the information about an entity for making resource allocation decisions referred to in the objective of financial reporting. SAC 1 does not identify reporting entities merely on the basis of parties with a casual interest in the entity's activities, rather the identification of entities that should prepare general purpose financial reports depends on the identified objective of financial reporting. Subject to cost/benefit considerations, when there is a legitimate demand for information a user cannot command entities should be required to prepare general purpose financial reports. Accordingly, the AASB proposes, as a starting point, the definition of a reporting entity in the Australian SAC 1:

Reporting entities are all entities (including economic entities) in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources. [SAC 1, paragraph 40]

Section 2: Group reporting entity

Question 3

Do you agree that the risks and rewards model does not provide a conceptually robust basis for determining the composition of a group reporting entity and that, except to the extent that it overlaps with the controlling entity model (as discussed in paragraphs 102 and 103), the risks and rewards model should not be considered further in the reporting entity phase of the conceptual framework project? If not, why?

7. The AASB believes that the risks and rewards model as described in the DP would generally not, of itself, provide a robust basis for determining the boundaries of a group reporting entity. However, risks and rewards may be given a complementary role as a potential indicator of control, particularly in determining whether the benefit element of control is met. An example of where 'risks and rewards' are used to complement the concept of control is in determining whether special purpose entities (SPEs) are controlled by an entity.
8. The AASB notes that, although conceptually a model can be envisaged where the boundaries of a reporting entity could include all items that give rise to financial risks to that entity and, when applicable, related rewards, this may overstate the value of the resources that the entity may deploy. As a result, a more practical version of the model has emerged in the literature where the boundaries of a reporting entity would include items in which that entity is exposed to the majority of risks and rewards.
9. Using 'risks and rewards' as the concept for determining the boundaries of a group reporting entity is conceptually distinct from using 'control' for that purpose. A risks and rewards model does not include a power element. Under an approach that relies

only on risks and rewards, the boundaries of the group reporting entity may include entities over which there is no power to direct financing and operating policies. However, under a control approach, no limit is set on the extent of benefits to be received.

Question 4

Assuming that control is used as the basis for determining the composition of a group reporting entity, do you agree that:

- (a) control should be defined at the conceptual level?**
 - (b) the definition of control should refer to both power and benefits?**
10. The AASB is of the view that the concept of control as the basis for determining the boundaries of the group reporting entity should be defined at the conceptual level. The AASB agrees, in principle, with the working definition of control proposed in the DP. Standards level clarifications and commentary would be needed to facilitate its application.
 11. It would be helpful if the basis for the wording of the definition of control could be more fully articulated. For example, it would be helpful to explain why the definition refers to ‘increasing’, ‘maintaining’ or ‘protecting’ the amount of benefits and reducing the amount of losses and to know what would be the implications of not including them.
 12. The DP has not dealt with the benefit criterion in sufficient detail compared with the power criterion. Some benefits are in forms other than cash flows, for example benefits could flow in the form of satisfying the objectives of the controlling entity. Under a proprietary approach, benefits would be the flow of cash from the controlled entity to the controlling entity. Under this view, the controlled entity is treated like an asset. However, there are benefits beyond proprietary flows. The DP alludes to this when it mentions ‘cash flows and other benefits’ (paragraphs 68, 92 and 127). It is therefore desirable for the benefits notion to be further explained, and expanded to cover forms other than cash flows.

Question 5

Do you agree that the composition of a group reporting entity should be based on control? If not, why? For example, if you consider that another basis should be used, which basis do you propose and why?

13. The AASB believes that the default basis for determining the composition of a group reporting entity should be control. However as noted in relation to Question 3, there are occasions when a consideration of risks and rewards is instrumental in determining where control resides. SIC 12 relies on an analysis of risks and rewards in determining control. Unless a definition of control can be developed that can deal with situations such as those that currently require an analysis of risks and rewards, the determination of the composition of a group reporting entity cannot be based on control alone and must be complemented by other concepts.
14. Paragraph 78 of the DP refers to it being “unusual to have a majority stake”. It is not clear to the AASB whether the reference to stake is a reference to only ownership. If it is, then the DP inappropriately argues in favour of majority ownership being the primary conceptual criterion for determining whether to include an entity in a group

reporting entity—although we concede that this may not have been the intended meaning.

Question 6

Assuming that control is used as the basis for determining the composition of a group reporting entity, do you agree that the controlling entity model should be used as the primary basis for determining the composition of a group entity?

If not, why?

15. The AASB believes that the controlling entity model should be used as the primary basis for determining the composition of a group reporting entity.

Question 7

Do you agree that the common control model should be used in some circumstances only? If not, why? For example, would you limit the composition of a group reporting entity to the controlling entity model only? Or would you widen the use of the common control model? If you support the use of the common control model, at least in some circumstances, do you regard it as an exception to (or substitute for) the controlling entity model in those circumstances, or is it a distinct approach in its own right?

Please provide reasons for your responses.

16. The AASB believes that ‘control’ should be the centrepiece of the model for determining the boundaries of an entity that reports. The AASB also notes that control may or may not be achieved through a parent. There are group structures both in the for-profit and the not-for-profit sectors in Australia where a common control model may need to be used. In the for-profit sector, dual listed company arrangements¹ and stapled securities arrangements are examples of the existence of control without a parent². Having stapling arrangements in a controlling entity model is difficult although there is also an alternative view that the arrangement in a stapling is the controlling entity.
17. It is common to have a private sector not-for-profit entity and a for-profit entity linked such that a parent cannot be identified, particularly where the costs of the not-for-profit entity are borne by the for-profit entity.

¹ Some legal entities listed on the Australian Securities Exchange have entered dual listed company (DLC) arrangements under which activities are managed as a single economic entity under contractual arrangements between two or more companies, while each company retains their separate legal identity. In these cases one entity has not acquired an ownership interest in the other entity and the individual legal entities have not been combined into a new legal entity. The securities of the entities comprising the DLC are normally quoted, traded or transferred independently in different capital markets. The contractual agreements underlying a DLC result in an economic entity in which the shareholders of the contracting companies have a common economic interest, including arrangements to ensure that all shareholders receive equivalent dividends, irrespective of the particular contracting company in which they hold shares.

² In Australia, some legal entities have issued equity securities that are combined with (‘stapled to’) the securities issued by another legal entity by virtue of a contractual arrangement between the entities. The securities of each legal entity that form the ‘stapled securities’ cannot be traded or transferred independently and only the stapled securities have a quoted market price. The stapling of the equity securities of two or more legal entities results in those entities having equity holders in common.

Section 3: Parent entity financial reporting

Question 8

Do you agree that consolidated financial statements should be presented from the perspective of the group reporting entity, not from the perspective of the parent company's shareholders? If not, why?

18. The entity perspective has always been the perspective adopted in standard setting in Australia and has been well received in the Australian financial reporting environment. Accordingly, consistent with the entity perspective used in the Objectives phase, the AASB supports the presentation of consolidated financial statements from the perspective of a group reporting entity. A group reporting entity perspective results in financial statements that present all the assets, liabilities, revenues and expenses under the control of the parent, which is important because the users of financial statements form a broader group than parent entity equity investors. In addition, parent entity focus can give rise to inappropriate and irrelevant information in the context of some groups such as with stapled securities arrangements in the Australian environment.

Question 9

Do you agree that consolidated financial statements provide useful information to equity investors, lenders and other capital providers? If not, why?

19. We agree that consolidated financial statements that use the concept of control in determining the composition of group reporting entity satisfy the objective of financial reporting, that is providing information to users to enable them to make decisions. This does not, however, mean that in some instances additional information about the parent entity in the form of separate financial statements, or disclosures in consolidated financial statements, is not needed.
20. It is not clear whether the DP is proposing that consolidated financial statements need not incorporate a controlled entity using line-by-line consolidation. This is a significant issue in Australia. Accordingly, the AASB believes that the discussion paper should include an explicit statement that its references to consolidated financial statements in the Framework do not necessarily imply line-by-line consolidation of a controlled entity, and that the accounting consequences of there being a controlled entity is a standards-level issue rather than a framework-level issue.

Question 10

Do you agree that the conceptual framework should not preclude the presentation of parent-only financial statements, provided that they are included in the same financial report as consolidated financial statements? If not, why?

21. The AASB agrees that the conceptual framework should not preclude the presentation of parent entity related information whether in the form of parent-only financial statements or disclosure in the consolidated financial statements. We believe parent-only financial reports would only provide useful information if they are published in conjunction with consolidated financial statements. This is because parent-only financial statements are not regarded as general purpose financial statements on the grounds that they do not present all the assets, liabilities, revenues and expenses under the control of the parent.

22. Some parent entity information may be needed by stakeholders to assess the liquidity and solvency of the entity in which they have a direct investment. Australian law currently requires dividends to be paid out of the profits of the individual entity and therefore parent only information would be useful in assessing the entity's ability to pay dividends.
23. The AASB undertook a study of the information needs of the users of parent entity financial statements in 2003. Among other things, the study concluded that parent entity financial reports are more likely to be required when the parent:
- (a) conducts substantive operations, including treasury operations;
 - (b) is a borrowing entity;
 - (c) singularly guarantees the debt of one or more of the subsidiaries; or
 - (d) is unable to gain unfettered access the cash flows of subsidiaries.
- The study recommended that , in the absence of the above circumstances, the consolidated financial report should, among other things, disclose:
- (a) the parent entity's shareholders' funds, including dividends and related tax credits, if different from the consolidated amounts;
 - (b) the manner in which the group is structured, including which entity within the group conducts the major trading and treasury operations;
 - (c) in which entities the group's borrowings and contingent liabilities reside; and
 - (d) guarantees and indemnities in place, including which entities are party to the guarantees.
24. The AASB notes that there is ambiguity regarding the meaning of the word 'included' in Question 10. For example, a customary way of including parent-only financial statements in the consolidated financial report is by preparing two columns, one reflecting consolidated figures and the other column showing parent-only figures. The DP should clarify that the way the parent-only financial statements are included in the same report as consolidated financial statements will be dealt with at the standards level.

Section 4: Control Issues

Question 11

With regard to the concept of control, in the context of one entity having control over another, do you agree that:

- (a) **establishing whether control exists involves assessing all the existing facts and circumstances and, therefore, that there are no single facts or circumstances that evidence that one entity has control over another entity in all cases, nor should any particular fact or circumstances—such as ownership of a majority voting interest—be a necessary condition for control to exist? If not, why?**
25. The AASB believes that whether an entity has control of another entity will always be a question to be decided in the light of the prevailing circumstances. The determination of the existence of control will entail the exercise of professional skill and judgement by the preparer and auditor of the financial report with a view to representing the situation faithfully. Faithful representation may entail additional disclosures about the

application of judgement. Accordingly, the AASB agrees that there is no single fact or circumstance that evidences that one entity controls another entity in all cases nor should any particular fact or circumstance act as a necessary condition for the existence of control.

26. We believe, however, that the clarification of this principle is a standards level issue since it would need to be complemented by detailed analysis of some of the facts and circumstances countered in practice.
 - (b) **the concept of control should include situations in which control exists but might be temporary? If not, why?**
27. The AASB believes that temporary control does not, of itself, affect the group reporting entity for which consolidated financial statements are to be prepared. During the time that control is held and until such time as control ceases, the subsidiary is part of the group reporting entity and needs to be reflected in the consolidated financial statements. Accordingly, the AASB agrees that the concept of control should include temporary control.
28. There may be a need to address practical issues that arise from temporary control at a standards level. For example, there are issues that may need to be addressed in relation to parent entities that are investment vehicles and which regularly buy and sell interests in controlled entities.
 - (c) **the control concept should not be limited to circumstances in which the entity has sufficient voting rights or other legal rights to direct the financing and operating policies of another entity, but rather should be a broad concept that encompasses economically similar circumstances? If not, why?**
29. The AASB agrees with the statement. For example, it may be possible to control the voting rights of another entity without holding a majority interest in the voting rights. This would happen where, in the absence of another entity dominating the composition of the board of directors, voting rights held by one entity, while less than 50 per cent, constitute a majority of those voting rights that can be exercised in a coordinated manner.
 - (d) **in the absence of other facts and circumstances, the fact that an entity holds enough options over voting rights that, if and when exercised, would place it in control over another entity is not sufficient, in itself, to establish that the entity currently controls that other entity? If not, why?**
30. The AASB agrees that in the absence of other compelling evidence indicating that the exercise of the options is highly probable, the holding of options over voting rights, in itself, does not amount to control.
 - (e) **to satisfy the power element of the definition of control, power must be held by one entity only? In other words, do you agree that the power element is not satisfied if an entity must obtain the agreement of others to direct the financing and operating policies of another entity? If not, why?**
31. The AASB believes that a significant feature of control is that the controlling entity's power to direct is not shared with others. The capacity to act, which is at the core of the

power element, cannot be shared or divided. An entity lacks this capacity and therefore power if it needs the agreement of other parties to act.

- (f) **having ‘significant influence’ over another entity’s financing and operating policy decisions is not sufficient to establish the existence of control of that other entity? If not, why?**

32. The AASB agrees that significant influence is not sufficient to establish the existence of control. When there is significant influence, the investor controls the asset it holds, being its equity interest in the investee, but it does not control the individual underlying assets and liabilities of the investee, nor any proportion of them.

Question 12

Should any of the above control issues be addressed at the standards-level rather than at the concepts level? If so, which issues and why?

33. The AASB believes that issues of ‘principle’ should be discussed at the concepts level and the interpretation or clarification of those principles when applied to practical situations should be relegated to the standards level. Accordingly, issues covered by paragraph 141(a), (b) and (d), that is ‘determining when one entity has control over another’, ‘control other than by legal rights, and ‘power is not shared with others’ should be discussed at the concepts level. Issues noted in paragraph 141(e), that is ‘control, joint control, and significant influence’ has traditionally been discussed at the standards level. While control and joint control could be discussed at the concepts level, it is arguable that ‘significant influence’ may not be appropriate for a conceptual analysis. Initial consideration of the issue by G4+1 group of standard setters in 2001 points to the difficulty of defining the term unambiguously. Interpretation of the capacity to exercise control is a standards level issue and issues under paragraph 141(c), that is ‘latent control and treatment of options’ would fall into this category.

Question 13

Are there any other conceptual issues, relating either to the control concept or to some other aspect of the reporting entity concept, that are not addressed in this discussion paper and should be addressed at the concepts level? If so, which issues and why?

34. The issue of control where there is less than a majority interest (either in capital or voting rights) needs to be clarified.

Suggestions for Editorial Amendments

Paragraph	Comment
P2, 36	In paragraph P2 (see second sentence) and various following paragraphs (e.g., paragraph 36, last line), ‘boards’ is used without any capitals, whereas the ballot draft exposure draft on Objective and Qualitative Characteristics uses “Boards”.
24	In the second sentence, the title of the exposure draft for the first phase of the project should include ‘Financial Reporting’ before ‘Information’.
101	In the third line, we think ‘worth while’ should be amended to ‘worthwhile’.
104	References to ‘drawing bright lines’ may need to be replaced with other more appropriate expressions, because that expression is colloquial and is in common usage only in a limited number of countries, and its meaning may be difficult to appreciate without having seen it used in particular contexts.
106(a), 118	In this paragraph and the following discussion, we wondered why ‘parent company approach’ was used instead of ‘parent entity approach’. A consequence of using ‘company’ is that in paragraph 118 (second sentence) and subsequently, references are made to “shareholders” rather than to holders of equity interests or ‘owners’ (and thereby may be interpreted as inappropriately excluding unit holders and the like). The section’s heading is ‘parent entity financial reporting’.
106(b)	There is an overlap between “which sets” in the second line and “whether both sets” in the last line. We suggest amending the sub-paragraph to “... determining which of those sets of financial statements (which may be either or both) meets the objective of general purpose financial reporting.”
107	We found it difficult to read the penultimate sentence because it refers to the parent company approach vis-à-vis the proprietary perspective and entity perspective without first describing what the parent company approach is.
109	In the last sentence, we think “claims on those resources (eg its liabilities and equity interests)” should be “claims on those resources (ie its liabilities and equity interests)” and “the entity’s resources and claims on them (eg. its revenues and expenses)” should be “the entity’s resources and claims on them (i.e. its revenues and expenses)” [difference highlighted in bold print].

Paragraph	Comment
147(a)	We think the first two lines should be amended to: “there is no single fact or circumstance that evidences that one entity has control over another entity in all cases, nor should any particular fact or circumstance ...”.

Appendix

AASB's Comments on Implications of the Proposed Concepts if They Were Applied to Not-For-Profit Entities

The reporting entity concept

- A1. It is important in the context of the not-for-profit sector that the reporting entity can be an entity that is not a legal entity. In the not-for-profit sector, there may be organisations with distinct existence that might lack legal status but in respect of which there are users who are interested in their activities and to whom their management should be accountable. For example, they may be administrative units that are separately accountable to a community and their elected representatives but which do not have a separate legal personality. Restricting reporting entities to only those organisations with a legal status would preclude those users from receiving general purpose financial reports about those organisations. Moreover, there may be organisations in respect of which there is high public interest and the public's elected representative cannot command specific information for accountability purposes. In such cases general purpose financial reports should be prepared by the entity.
- A2. If the term 'business activity' has a for-profit connotation, there may be a problem in applying it to the not-for-profit sector. The AASB agrees with the Monitoring Group's³ view that it would be appropriate to consider using a term other than 'business activity' that could be applied in both a for-profit and a not-for-profit context.
- A3. Private and public sector not-for-profit entities have potentially a different and wider user group than the entities in the for-profit sector. They comprise resource providers, recipients of goods and services, parties performing a review or oversight function and management and governing bodies.
- A4. SAC 1 continues to have relevance in Australian financial reporting especially in the public sector. Its generic definition of a reporting entity by reference to the existence of dependent users and the guidance provided are useful, particularly in the context of General Government Sectors and Government Departments.
- A5. While independent regulators may stipulate which private sector entities should prepare general purpose financial reports, this does not generally apply in the not-for-profit public sector. There may be a greater need in the not-for-profit public sector for a definition of a reporting entity to provide a conceptual basis for informed decisions by local legislators in identifying reporting entities.
- A6. The AASB agrees with the comments of the Monitoring Group that the DP's focus on capital providers as users of financial reports in its description of a reporting entity is too narrow for application in the not-for-profit sector. The AASB agrees with their view that funders and financial supporters should also be identified as capital providers and that recipients of goods and services and members of not-for-profit

³ The Group consists of Chairs and senior staff members of standard-setting bodies in Australia, Canada, New Zealand and the United Kingdom. The group has been monitoring the development of the IASB-FASB joint conceptual framework project from the perspective of private and public sector not-for-profit entities. It comments on the applicability to not-for-profit entities in the private and public sectors of the concepts proposed in the DP can be reached on the AASB website at www.aasb.gov.au.

entities should also be considered primary user groups for not-for-profit entities and the description or definition of a reporting entity should be amended accordingly.

- A7. The AASB has commented in the main body of its submission that the disaggregation problem needs to be considered in more detail in the DP. Accordingly it supports the Monitoring Group's account of some reporting entity issues that may arise in the not-for-profit sector in particular whether and in which circumstances branches or other sub-entities of a not-for-profit entity constitute reporting entities. An example may be when fundraising occurs at a branch level and where user decisions are made and the discharge of accountability is appropriate at that sub-entity level.

Group reporting entity

- A8. As noted in the attached submission, the DP has not dealt with the benefit criterion in sufficient detail compared with the power criterion. There is a need for a broader notion of benefits than cash flows particularly in the not-for-profit sector. In a not-for-profit context benefits could flow in the form of satisfying the objectives of the controlling entity, in the form of delivery of goods or services to the controlling entity or to the public on behalf of the controlling entity. A controlling entity may derive both financial and/or non-financial benefits from a controlled entity. For example, a government business enterprise may provide a controlling entity with a dividend and also enable it to achieve some of its social policy objectives.
- A9. Instances exist in the Australian public sector that justifies the use of a common control model. This usually occurs at higher levels of government such as the whole-of-government level, where it is difficult to identify the controlling entity. There is also an alternative view that, from a legal perspective, Cabinet may be considered to be the controlling entity in such cases. The AASB believes that the issue should be further explored in relation to the not-for-profit sector as proposed by the Monitoring Group.

Control issues

- A10. The AASB concurs with the Monitoring Group's view that, in the context of not-for-profit entities, the application of control (as defined to date by standard-setting bodies) has sometimes been difficult and the proposed definition should be assessed against the range of circumstances that arise in this sector to determine whether the definition is appropriate and whether additional commentary could be developed to assist in standards-level decisions. As noted above, the benefit criterion would need to be expanded in the context of the not-for-profit sector to encompass benefits that are not in a cash flow form or are received by the controlling entity through the satisfaction of its objectives by the controlled entity.
- A11. A public-sector-specific issue is whether control of an entity by government should require it to have responsibility for management of (or involvement in) the day-to-day operations of the other entity. For example, some argue that the operating policies of courts and supreme audit institutions with statutory or constitutional independence of decision-making cannot be directed by another party, and therefore that these public bodies would not form part of the government reporting entity. It is noted that the government's existing authority to determine the policies governing the activities of such entities is important. Moreover, the government accepts responsibility for funding of such entities. They often cannot set their own budget and the government receives the benefit of their independent operations.

- A12. Some of a government's legislative powers establish the regulatory framework within which entities operate in both the public and private sectors. Such regulatory power does not constitute control possessed by the government or a government-controlled entity over the assets deployed by these entities. For example, although a government authority may have the power to close down the operations of entities that do not comply with emission control regulations, this power does not constitute control by that authority because it only has a regulatory power.
- A13. The ability of governments to change legislation raises the question of whether governments possess the capacity to direct the financing and operating policies of a wide range of private sector entities such as charities, other not-for-profit entities and even private sector for-profit entities. Presently, it is widely held that the currently exercisable control should be the norm in public sector and therefore the capacity of governments to legislate to control certain private sector entities or expropriation of certain assets does not amount to control. This view is consistent with the general conclusion in paragraph 155 of the DP that when an option holder holds sufficient options that, if exercised, would place it in control of another entity, that is not sufficient, in itself, to establish that the option holder has present control over that other entity.
- A14. In some situations an entity is economically dependent on a public sector entity but retains discretion as to whether it will take funding from, or do business with, the public sector entity. In this case, the first entity has the ultimate power to govern its own financing or operating policies, and accordingly is not controlled by the public sector entity. An example is where a public sector entity can influence the financing and operating policies of another entity that is engaged in charitable activities because the charity is dependent on it for funding. Here, in the absence of other circumstances, the agreement to provide funding would not constitute control by the public sector entity.
- A15. Not-for-profit entities in the private sector are generally characterised by the absence of defined ownership interests that can be sold, transferred or redeemed or that convey an entitlement to a share of a residual distribution of resources, including on liquidation of the entity. In assessing control relationships, further consideration may be necessary of issues that arise as a consequence of this characteristic.