

Summary of Comments by Participants at the ITC 17 Roundtables in Melbourne 14 August 2008

(Shaded questions are those discussed at the Roundtable.
Text boxes show the views expressed.)

General themes emerging from discussions supported by, at least, a reasonable number of the participants.

- ✓ Support for a notion of a reporting entity that is broader than legal entity.
- ✓ Support for a precise definition of a reporting entity similar to that in SAC 1.
- ✓ Support for considering public interest at a conceptual level and expanding the sphere of users in the description/definition of a reporting entity to include public interest.
- ✓ Support for expanding the discussion of the benefit criterion to better articulate the flow of benefits in forms other than cash.
- ✓ Support for primacy of the controlling entity model and permitting a common control model in applicable circumstances.
- ✓ Support for the economic entity view in preparing financial reports.

Section A: Questions from the IASB DP Supplemented by AASB Not-for-profit Questions

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?

- A notion of a reporting entity that is broader than the legal entity is desirable.

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?

- The Discussion Paper (DP) is about describing the boundary of the entity that is the subject matter of GPFRs. The DP approach is not concerned with who should report. The focus is the GPFR rather than the reporting entity. Therefore, an entity may prepare a GPFR without being a reporting entity.
- The DP effectively states that an entity cannot be a reporting entity and not prepare a general purpose financial report. That is, the DP focuses on entities that cannot be reporting entities rather than entities that should be reporting entities. The IASB, however, has not clarified what a reporting entity is because its focus is on the negative.
- On the advantages and disadvantages of a description (or a broad definition) rather than a precise definition of a reporting entity it was noted that :
 - (a) A strength of a broad definition or description is that it helps overcome manipulation, for example, through structures that facilitate off-balance sheet items. However, a broad description may capture even sole proprietorships, which may not be desirable.
 - (b) A broad description is free of jurisdictional issues and, therefore, local national standard setters or legislators could modify it for their own reporting environment. The breadth of the description may work because not all reporting entities would necessarily report.
 - (c) There is a concern that the IASB has decided to make the determination of what is a reporting entity a function of local legislation. This may lead to a situation at the jurisdictional level where business sector entities would be able to avoid general purpose financial reporting. Accordingly, a generic definition at the global level is needed.
 - (d) Not defining a reporting entity in a precise way will make it difficult for both the entity and the practitioner providing accounting services to determine whether the entity is a reporting entity. As such, the approach in SAC 1, and guidance provided in that statement are considered helpful.
- On the DP reference to capital providers in the description of a reporting entity it was noted that:
 - (a) ‘Capital provider’ has a capital market focus. It may only work well in environments where capital markets are a dominant feature such as for the FASB in the United States. Its applicability to other jurisdictions may need to be further explored.
 - (b) The term ‘capital provider’ does not cover ‘public interest’. It was noted that while it is up to the standard setter to assess public interest, it may be appropriate to acknowledge public interest at the concepts level and in the description of the reporting entity. Others noted that, while there are issues with the term capital provider, including the issue of public interest, the reporting entity phase of the conceptual framework project is not the place to deal with them, rather these are matters for the objectives phase.

- The SAC 1 approach to defining a reporting entity is preferred. It gives a clearer connection between a reporting entity and objectives of financial reporting.
- The IASB definition/description of a reporting entity is problematic, vague, and has a private sector orientation.
- The term ‘business activity’ in the DP description of a reporting entity is not sufficiently generic. Others noted the term ‘business’ can have different connotations and may need to be defined. It was asked whether Special Purpose Entities (SPEs) would constitute businesses.
- Throughout the DP, the analysis appears to have been made with only for-profit incorporated entities in mind.
- While the legal entity should be the natural start to the discussion of a reporting entity, the DP should consider circumstances which require aggregation and disaggregation. It seems the discussion of disaggregation is not adequate. Care is needed to distinguish between reporting entities being a disaggregation and presenting disaggregated information. Others noted that the word ‘circumscribed’ in the description of a reporting entity is an imprecise term which may allow disaggregated units to be classified as reporting entities.

NFP dimension

Question 2A What specific issues not addressed in the DP might arise in determining what constitutes a reporting entity in a NFP context? For example, do you think there is a need for a different description of a reporting entity on the grounds that NFP entities might be considered to have a broader primary user group than for-profit entities?

- The word ‘business’ in the description of a reporting entity has a for-profit focus. It was noted that one might broadly be able to say ‘business of government’ in the public sector. However, if ‘business’ is assessed as having a for-profit connotation, then there is a problem in relation to its use in the NFP sector.
- The circumstances in the NFP sector also confirms that the DP approach of allowing for an entity that is not a legal entity to be a reporting entity is desirable.
- Capital provider is too narrow to work in relation to the NFP sector. For example, it is not clear whether membership income of a NFP entity can be classified as capital provided. Others argued that this should be dealt with separately in the context of the NFP sector.
- Providing capital could be interpreted broadly to encompass any contribution. Accordingly, in the case of charities, funders who pay membership fees or provide voluntary labour would be capital providers.
- The focus in the NFP sector is on the way funds are spent, rather than provided.
- To overcome the deficiencies in the term ‘capital provider’ the term ‘resource provider’ could be used instead since it is a broader term and is applicable to both for-profit and NFP sectors. However, it was noted suppliers may also be caught if the term resource provider is used.

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?

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?
If not, why? For example, do you have an alternative proposed definition of control?

NFP dimension

Question 4A What issues not addressed in the IASB DP might arise in applying the concept of control as defined in the IASB DP in a NFP context? For example, consider the following:

- (a) It has been argued that the notion of benefits in the context of a NFP definition of control may need to be expanded to include achieving the objectives of the controlling entity rather than only accessing benefits flowing from that other controlled entity. Do you consider it would be appropriate to broaden the notion of benefits in the working definition of control in the IASB DP for application in a NFP context?
- (b) Even if this notion were expanded, would it help in circumstances where the objectives of two or more entities coincide? For example, a government may establish a regulatory framework that a private sector NFP entity can elect to impose on themselves to more effectively achieve their own objectives (which coincide with the government's objectives). Does this make the private sector NFP entity a 'controlled' entity of the government?
- (c) Do you consider the definition of control is workable when the government establishes an entity through legislation that operates independently of government, for example, the judiciary (some of these entities are sometimes referred to as 'autopilot' entities)?

(Questions (b) and (c) are exploring the relationship between regulation and control)

- The DP has not dealt with the benefit criterion in detail compared with the power criterion. Under a proprietary approach, benefits would be the flow of cash from controlled entity to the controlling entity. Under this view, the controlled entity is treated like an asset. There are benefits beyond proprietary flows. The DP alludes to this when it mentions 'cash flows and other benefits' in discussing the working definition of control.
- Some of the public sector benefits are in forms other than cash flows. Benefits could flow in the form of satisfying the objectives of the controlling entity but the coincidence of objectives between the controlling entity and the controlled entity does not necessarily lead to control. There is a need for a broader notion of benefits than cash flows, although it is feasible to consider other forms of benefits in cash flow terms even in the NFP sector.
- In public sector reporting, there has been a disconnect between impairment testing and cash flows, for example in regard to assets such as statues and parks. However, the statue or park impairment is no different from impairment of assets in the for-profit sector if revenue is considered.
- It is desirable for the benefits notion to be expanded not restricted. Loss making subsidiaries might be worth keeping since cash flow is protected elsewhere in the group. It was noted that benefits should be better explained both in the for-profit and the NFP context.
- There is a need for a benefit test for public trustees. SPEs do not provide benefits to an entity. Although some noted the benefit of SPEs might be their function in distancing activities from the creators.
- The Government accepts responsibility for funding/bearing costs of certain authorities. Independent public sector entities such as the judiciary often cannot set their own budget and the Government receives the benefit of their independent operations.
- The 'soft' power of government should be covered in the discussion of control in the public sector. Others noted this is in the nature of an indicator of control and a standards level issue. Also, in relation to control by legislation, currently exercisable control should be the norm in the public sector although this is also a standards level issue.

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?

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?

- Control may not be clear-cut in the NFP private sector as in the case of some companies limited by guarantee.
- Some of the material in relation to control included in the DP are standards level issues and should not be discussed in a concepts document.
- It was regarded as uncertain whether control exists in cases where the power criterion is satisfied fully but there is little benefit.
- The discussion of control has glossed over SIC 12 issues, that is, the relationship between control and risks and rewards. It was noted that under a controlling entity model, there is a basic level of control but there are also other issues as noted in SIC 12.
- DLCs and stapled securities arrangements are examples of common control structures. It would be difficult to have stapling in a controlling entity model. However, there was a view that the arrangement in a stapling could be the controlling entity.
- The common control model is prevalent in the public sector. In some traditional cases, such as Australian Broadcasting Corporation, the controlling entity model is being used but at higher levels, such as whole-of-government, it is harder to use the controlling entity model. However, from a legal point of view, Cabinet may be considered to be the controlling entity in such cases.
- The determination of boundaries under a common control model needs to be addressed.
- It is common to have a NFP entity and a for-profit entity linked such that a parent cannot be identified, particularly where the costs of the NFP are borne by the for-profit entity.
- Control is the centrepiece. The entity is whatever is controlled. However, control may or may not be achieved through a parent.
- Under the common control model, there is a concern that people will choose to exclude particular entities from the group when it suits their purpose, unless the model is well articulated.
- In some cases such as Churches, the structure is such that the parent may not be able to be identified.
- The controlling entity model generally works well in the Australian for-profit environment.
- Control is not predicated on there being a parent. Examples of the existence of control without the need for a parent are DLCs and stapling arrangements.

Parent Entity Financial Reporting

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.

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?

- A genuine set of parent entity statements that uses only the proprietary view has been rare. In one case, a genuine parent entity report was prepared using proportionate consolidation reflecting full proprietary view.
- The AASB should support an economic entity perspective because it is consistent with the entity perspective used in the Objectives phase.

Question 9

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

- The IASB and FASB view is that consolidated financial statements are GPFs and to show a proper view of the reporting entity, consolidated accounts should be prepared.

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?

- The objective of the question is unclear. Is this a standards level question?
- Parent entity reports are not GPFRs and that is why they should be presented together with group financial reports. In some jurisdictions both the group and parent-entity financial reports are regarded as representation of the group, the difference is seen as being in the presentation.
- The proposal ignores the need of users who might want the separate entity GPFR.
- The DP doesn't explain what is meant by 'included' in the financial report of a group. Is it proposing to move away from the traditional two column presentation?

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?
- (b) the concept of control should include situations in which control exists but might be temporary? If not, why?

Additional AASB question

Question 11(b)A Should the control by an entity of another entity necessarily entail line by-line consolidation of the controlled entity?

[Note: The IASB DP does not explain how information about controlled entities should be presented in the consolidated financial statements, such as whether consolidation always means a line-by-line consolidation, or whether a one-line consolidation method or some other consolidation method could (or should) be used. Rather, the IASB DP states that issues relating to the presentation of particular components of the reporting entity should be addressed at the standards level and involve applying concepts from other phases of the project, such as the definition of elements (including the unit of account), measurement, presentation and disclosure, and the qualitative characteristics of financial reporting information (see paragraph 137 of the IASB DP)]

- (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?

- (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?
- (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?
- (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?

- Superannuation plans and managed investment schemes are examples where the control of investments can be temporary.
- SPE's relationships can change. Banks may reduce funding, or refuse to top up funding, putting the existence of a SPE in jeopardy.
- The term 'temporary' needs to be clarified or defined. Others were of the view that this is a standards level issue. It was noted that the held-for-sale notion (in AASB 5) is an example of temporary control.
- Conceptually, consolidation of a controlled entity should not be limited to a line-by-line consolidation.
- The DP talks about line-by-line consolidation in some places while elsewhere it says the consolidation approach should be left to the standards level. Some improvement in drafting is needed to make the discussion clear and consistent.
- The IASB already has an exception to line-by-line consolidation with respect to discontinued operations.

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?

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?

Section B: Other AASB Questions

Question B1:

Are there any issues in SAC 1 *Definition of the Reporting Entity* (other than the issue of using the reporting entity for differential reporting purposes) not dealt with in the IASB DP that should be carried over to a future AASB Framework? In particular, should the reporting entity concept in the revised IASB Framework be used as a basis for determining who should report?

In this context, from a public sector perspective, are there any circumstances in which entities should be required to report? For example:

- (a) General Government Sectors
- (b) Government Departments

- There is no need for SAC 1 if the differential reporting requirements in Australia undergo the changes currently tentatively decided by the AASB.
- SAC 1 continues to have relevance in Australian financial reporting especially in the public sector. Its precise definition of the 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.
- Foreign governments that do not rely on a reporting entity concept for determining which entities should report have encountered problems. The SAC 1 definition helps identify the entities that need not prepare GPFRs.
- In the public sector, not all users can command information to suit their needs. For example not all MPs can demand the information they require. There also may be broader public interest. These factors require preparation of a GPFR.
- Publishing accounts by itself does not make them GPFRs. Holding them out as being GPFRs is the key.
- GPFRs of Government departments add very little value. Disaggregation of general government is really for accountability purposes.

Question B2

As indicated above, because the IASB-FASB joint conceptual framework project has an initial focus on for-profit entities in the private sector, the AASB plans to undertake additional consultation with constituents in relation to not-for-profit issues. This Roundtable is an initial step in that additional consultation. Accordingly, in addition to your responses to 'NFP dimension' questions above, in relation to the topic of 'reporting entity' covered by the Discussion Paper, do you have any comments on other issues that would need to be considered if the proposed concepts were also to be applied in Australia to NFP entities in the private and public sectors and for-profit entities in the public sector.

Question B3

Whether the proposals would result in financial reports that are useful to users.

Question B4

Whether the proposals in the Discussion Paper are in the best interests of the Australian economy.