Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Not-for-Profit Private Sector Financial Reporting Framework**	**Meeting:**	M181
Topic:	**Tier 3 – Reporting controlled and related entities**	**Agenda Item:**	3.3
		Date:	7 June 2021
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Objective of this paper

1 The objective of this staff paper is for the Board to **decide** its preliminary views on Tier 3 reporting requirements for a not-for-profit (NFP) private sector entity's interests in controlled entities (subsidiaries). In addition, as complementary topics, this staff paper also seeks the Board's preliminary views on Tier 3 reporting requirements for the entity's interests in associates and joint arrangements, the accounting for such investments in separate financial statements, and the accounting for a business combination.

Background

2 At its 20-21 February 2021 meeting, the Board agreed to develop a further reporting Tier (Tier 3) for application by not-for-profit (NFP) private sector entities. This reporting Tier is intended to be a proportionate response for application by some (but not all) NFP private sector entities that are currently preparing special purpose financial statements on the basis that the entity is not a reporting entity as defined in SAC 1 *Definition of the Reporting Entity*. In addition, this reporting Tier might be applied by some (but not all) NFP private sector entities that are currently preparing Tier 2 general purpose financial statements.

3 This staff paper is one of a series of staff papers to assist the Board in forming its preliminary views on detailed reporting aspects of the proposed reporting Tier 3, for inclusion in its discussion paper. Developing preliminary views in this regard will enable the Board to obtain useful feedback to inform it as to whether its proposed views should be further developed as part of a future exposure draft.

Reasons for bringing this paper to the Board

4 This staff paper primarily addresses the accounting for a NFP private sector entity's controlled entities. Staff think the Board should form preliminary views for inclusion in the discussion paper on the accounting for such related parties having regard to feedback from the targeted staff outreach conducted between August – October 2020 (see Appendix A) and from a recent AASB NFP Project Advisory Panel meeting suggesting that consolidation is one of the areas of challenges for NFP entities and that avoiding consolidation accounting may be a reason for entities electing to prepare special purpose financial statements over general purpose financial statements (refer paragraphs 43 and 44 below). While it is not obvious how many NFP private sector entities control another entity, staff note that the Australian Charities and Not-for-profit

Commission 2019 AIS datasets indicate there are at least 372 Tier 3-sized charitable organisations that are parent entities,[1] suggesting that groups are not wholly uncommon in the sector at the contemplated Tier 3 entity size, thereby providing reason for the Board to consider the accounting in this regard.

5 Staff also note that, having regard to cost/benefit considerations, whether a parent entity should be required to consolidate its controlled entities was a subject of discussion as part of the Board's deliberations on its revised Tier 2 reporting requirements.[2] Given that the Board is now discussing a further 'simpler' reporting Tier, staff think it appears relevant to reassess this topic for the purposes of determining preliminary Tier 3 reporting requirements for inclusion in its forthcoming discussion paper; analysing the requirement now against the principles determined at the Board's April 2021 meeting.

6 While the stakeholder feedback pertained to concerns about the preparation of consolidated financial statements, staff think that it would be useful to discuss at the same time as the Board preliminary decision on the accounting for controlled entities, the complementary topics of the accounting for interests in associates and joint arrangements, business combinations and accounting for these interests in separate financial statements, where presented.

Structure of this paper

7 This paper structured as follows:

(a) Summary of staff recommendations – paragraph 8;

Part A: Controlled entities

<u>Current Australian requirements</u>

(b) Current requirements for controlled entities under Australian Accounting Standards – paragraphs 9 – 11;

(c) Australian legislative requirements – paragraphs 12 – 15;

<u>Overview of other accounting requirements for controlled entities</u>

(d) Summary of approaches taken by selected other jurisdictions – paragraphs 16 - 39;

(e) Possible approaches to explaining control identified in the IFRS4NPO Consultation Paper – paragraphs 40 – 42;

<u>Support for change</u>

(f) Feedback from Australian stakeholders – paragraphs 43 – 44;

(g) Findings from AASB Research Reports – paragraphs 45 – 46;

<u>Proposed aspects for simplification</u>

(h) Simplification aspects for the accounting for controlled entities – paragraphs 47 – 48;

(i) Simplification aspect 1: Whether a controlled entity should be consolidated – paragraphs 49 – 70;

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1 The ACNC AIS 2019 dataset (last accessed 7 June 2021) shows a total 1,260 charitable organisations as preparing a report that consolidates at least one other entity (small charitable organisations: 24; medium charitable organisations: 293; large charitable organisations: 943). When the dataset results were restricted to those within the size range contemplated by the Board (revenue between $500,000 and $3million), this number was 372. A further filter of these results revealed that 180 of these entities prepared financial statements described as general purpose financial statements.

2 Refer paragraphs BC115-BC119 of AASB 2020-2 *Amendments to Australian Accounting Standards – Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities*.

(j) Simplification aspect 2: Whether to provide more guidance on control – paragraphs 71 – 75;

Part B: Related topics

Interests in associates and joint arrangements, Separate financial statements, Business combinations – proposed Tier 3 approach

(k) Possible Tier 3 requirements for associates and joint arrangements – paragraphs 76 – 77;

(l) Possible Tier 3 simplification for separate financial statements – paragraphs 78 – 81; and

(m) Possible Tier 3 simplification for the accounting for business combination – paragraphs 82 – 84;

(n) Appendix A: Preliminary feedback received from initial targeted consultations with stakeholders conducted during August – October 2020; and

(o) Appendix B: Extract from IFR4NPO Consultation Paper.

Summary of staff recommendations

8 Staff recommend proposing the following Tier 3 reporting requirements in a discussion paper for public comment:

(a) the consolidation of controlled entities should be allowed, but not required. This decision should be made with respect of each controlled entity and should not change from period to period, except where there is a justifiable reason for the change;

(b) the financial statements should include further information to help users understand the accounting for the economic entity, including summarised financial information of each controlled entity for which the results and financial position have not been consolidated as part of the prepared financial statements;

(c) that an investor's investments in associates and joint arrangements be accounted for in a similar manner to Tier 2 reporting requirements, except if the Board forms a preliminary view not to require consolidated financial statements to be prepared;

(d) that investments in controlled entities, associates and joint ventures in separate financial statements, where prepared, should be measured at cost less impairment; and

(e) that business combinations should be treated in a similar manner to Tier 2 reporting requirements.

Current requirements for controlled entities under Australian Accounting Standards

9 In accordance with AASB 10 *Consolidated Financial Statements*, in general, a NFP private sector entity preparing general purpose financial statements that comply with Australian Accounting Standards (Tier 1 or Tier 2) must consolidate its controlled entities and present consolidated financial statements. Exemptions and exceptions from the requirement to consolidate controlled entities are limited to instances where the (parent) entity is:

(a) controlled by another Australian entity (conditions apply); or

(b) an investment entity.

10 In recognition of challenges an NFP entity might face with identifying whether an entity controls another entity, in October 2013 the Board issued guidance in this regard. Appendix E

of AASB 10 sets out Australian implementation guidance for NFP entities to provide Australian NFP entities with guidance on assessing control.[3]

11 In addition, a NFP private sector entity that complies with AASB 1054 *Australian Additional Disclosures* in its special purpose financial statements must include disclosure of:

(a) whether or not an entity's subsidiaries and investments in associates or joint ventures have been consolidated or equity accounted in a manner consistent with the requirements set out in AASB 10 *Consolidated Financial Statements* or AASB 128 *Investments in Associates and Joint Ventures*, as appropriate. If the entity has not consolidated its subsidiaries or equity accounted its investments in associates or joint ventures consistently with those requirements, that fact, and the reasons why, is disclosed; or

(b) that the entity has not assessed whether its interests in other entities give rise to interests in subsidiaries, associates or joint ventures, provided it is not required by legislation to make such an assessment for financial reporting purposes and has not made such an assessment. (AASB 1054.9A(b)).[4]

Australian legislative requirements

12 Some Australian legislation governing NFP private sector entities establish the financial reporting obligations of the entity using size thresholds that reference consolidated amounts (e.g. *Corporations Act 2001*, NSW *Co-operatives (Adoption of National Law) Act 2012*). Other relevant Australian legislation establish the financial reporting obligations of the entity using size thresholds referencing the performance or financial position of the entity, rather than that of the economic entity (e.g. *Australian Charities and Not-for-profits Commission Act 201*2, the Victorian *Associations Incorporation Reform Act 2012*). In addition, from the stakeholder outreach conducted during August – October 2020 (refer Appendix A), staff understand that one regulator's current practice requires reference to consolidated amounts, even though its threshold test does not expressly refer to such.

13 Some Australian legislation requires only consolidated financial statements to be prepared, where required by the accounting standards (e.g. *Corporations Act 2001, Corporations (Aboriginal and Torres Strait Islander) Act 2006*). Other legislation:

(a) requires both financial statements of the consolidated entity and for the parent entity to be prepared (e.g. NSW *Co-operatives (Adoption of National Law) Act 2012*); or

(b) does not explicitly specify which financial statements are required but notes that they are the financial statements that are required to be prepared by the accounting standards (e.g. NSW *Associations Incorporation Act 2009*, *Australian Charities and Not-for-profits Commission Regulation 2013*).

14 In some cases, Australian legislation contemplates the exclusion of some (potentially controlled) entities from statutory consolidated financial statements. For example, NSW Incorporated Associations Class Order 11/01 exempts an incorporated association with revenue of less than $2 million from its statutory obligation to prepare financial statements that comply wholly with Australian accounting standards as long as certain conditions are met. In such cases the Class Order permits the entity to prepare a consolidated statement of income and expenditure and a consolidated balance sheet which consolidates its investments in subsidiaries, except for any trusts for which it acts a trustee in accordance with the financial reporting requirements for individual associations as set out above.

3 A post-implementation review of the Appendix is expected to be conducted in conjunction with the forthcoming AASB Agenda Consultation.

4 Per the AASB Policies, a post-implementation review of these requirements should commence in 2022.

15 NFP private sector entities that are registered as charities with the ACNC are required to lodge financial statements if the entity meets the ACNC's 'medium' or 'large' size threshold. The ACNC may permit, on application, for such individual reporting obligation to be relieved where the medium or large entity is part of an approved ACNC reporting group that reports jointly or collectively. The ACNC may allow reporting groups to submit consolidated financial statements or combined financial statements – where consolidated financial statements are submitted, the ACNC requires only the parent entity to lodge financial statements. These consolidated financial statements should comply with AASB 10 (i.e. whether or not the financial statements are general purpose financial statements or special purpose financial statements). The ACNC conditions for group reporting contemplate an 'impractical out' from consolidation. [5]

Summary of approaches taken by selected other jurisdictions

16 Paragraphs 17 to 39 below summarise the accounting approach of other jurisdictions with respect to controlled entities and consolidated financial statements.[6]

IFRS for SMEs

17 The IASB's *IFRS for SMEs* currently requires a parent entity to present consolidated financial statements in which it consolidates all of its investments in its controlled entities, including controlled special purpose entities. There is no exemption available in instances of 'undue cost or effort'.[7] An exception from consolidation applies only where:

(a) the parent is itself a subsidiary and its ultimate or intermediate parent produces consolidated general purpose financial statements that comply with full IFRS or with the *IFRS for SMEs*; or

(b) the subsidiary was acquired and is held with the intention of selling or disposing of it within one year from its acquisition date. Prior period financial statements may have to be restated (to consolidate the subsidiary) if the subsidiary is not disposed of within this time frame.

18 The mechanics of consolidating an entity and guidance on when an entity controls another entity (including a special purpose entity) is limited and is contained wholly within the Standard. The Standard specifies that control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an entity; however, this presumption can be rebutted. There are four scenarios where control exists when the parent owns half or less of the voting power of an entity; being when it is able to demonstrate that it has:

5 A condition for group reporting is that the reporting group's annual financial report must comply with AASB 10 and AASB 12 *Disclosure of Interest in Other Entities* to the full extent possible. Where a reporting group is not in full compliance with AASB 10 or 12, the ACNC group reporting conditions require the inclusion of a disclosure note in the financial report that provides reasons why and the extent to which compliance was impracticable. Per the ACNC AIS 2019 dataset, there are currently 281 reporting groups; and the ACNC 2019 review indicated that 6% of the 234 large and medium reporting groups did not meet the condition to comply with AASB 10 and AASB 12 to the full extent possible. (Reference: https://www.acnc.gov.au/node/3201736 and https://www.acnc.gov.au/tools/reports/reviewing-charities-financial-information-and-annual-financial-reports, last accessed 7 June 2021)

6 With respect to the accounting for controlled entities, staff did not consider IPSAS requirements because the AASB's NFP Standard-setting Framework is based on IFRSs and as the IPSASB has not issued a pronouncement similar to the *IFRS for SMEs*.

7 The *IFRS for SMEs* permits exemption from certain specified requirements on the basis of 'undue cost or effort'. Paragraph 2.14B of the Standard observes that this management judgement "… requires consideration of how the economic decisions of those that are expected to use the financial statements could be affected by not having that information. Applying a requirement would involve undue cost or effort by an SME if the incremental cost (for example, valuers' fees) or additional effort (for example, endeavours by employees) substantially exceed the benefits that those that are expected to use the SME's financial statements would receive from having the information. …"

(a) power over more than half of the voting rights by virtue of an agreement with other investors;

(b) power to govern the financial and operating policies of the entity under a statute or an agreement;

(c) power to appoint or remove the majority of the members of the board of directors or equivalent governing body and control of the entity is by that board or body; or

(d) power to cast the majority of votes at meetings of the board of directors or equivalent governing body and control of the entity is by that board or body.

19 Staff note that the IASB is currently undertaking a review of the *IFRS for SMEs*, and it is possible some of the current requirements may be amended following completion of that IASB project, including in response to stakeholder support for aligning the definition of control with that of IFRS 10 *Consolidated Financial Statements* (less clear is whether the IASB might align the requirements in the *IFRS for SMEs* with the investment entity exception that exists in full IFRSs). Staff also observe that the IASB received stakeholder feedback during its Request for Information seeking guidance for NFP entities applying the *IFRS for SMEs*.[8]

Canada

20 An entity incorporated under the Canada Not-for-profit Corporations Act is required to prepare annual Canadian GAAP-compliant financial statements.[9] An NFP private sector entity may prepare financial statements that comply with IFRS or with the requirements set out in Part III *Accounting Standards for Not-for-Profit Organizations* (ASNPO) of the CPA Canada Handbook.

21 Section 4450 of Part III specifies that a Canadian NFP entity has an accounting policy choice in how it accounts for the entities it controls. The accounting policy choice may differ for each different type of controlled entity:

(a) for its NFP controlled entities: by consolidation, or by disclosure. The extent of disclosure varies depending on whether the controlled entity is individually immaterial or otherwise, but includes, for each material unconsolidated controlled entity, summary financial information about the controlled entity. For immaterial controlled entities, the disclosures include the reasons why the controlled entity has not been consolidated;

(b) for its for-profit controlled entities: by consolidation, or by applying the equity method. Where the equity method is used, summary financial information about the entity is required.

22 Entities are referred to Part II *Accounting Standards for Private Enterprises* for the requirements that apply when consolidated financial statements are presented (including applicable disclosures). However, control is defined and (limited) guidance provided to explain when it is present in s4450. This includes, in respect of assessing whether a NFP entity controls

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8 Reference: IASB SME Implementation Group 4-5 February 2021 meeting, Agenda Paper 2 Comment letter summary; Agenda Paper 3 Online survey feedback summary; Agenda Paper 4 Outreach feedback summary and Agenda Paper 5 User survey and user interview feedback summary

9 s.172(1)(a) of the Canada Not-for-profit Corporations Act (S.C.2009, c.23) requires the directors of a corporation to place before the members at every annual meeting the prescribed comparative financial statements that conform to any prescribed requirements and relate separately to (i) the period that began on the date the corporation came into existence and ended not more than six months before the annual meeting or, if the corporation has completed a financial year, the period that began immediately after the end of the last completed financial year and ended not more than six months before the annual meeting, and (ii) the immediately preceding financial year. Paragraph 75 of the Canada Not-for-profit Corporations Regulations specify that the comparative financial statements are to be prepared in accordance with the generally accepted accounting principles set out in the CPA Canada Handbook – Accounting or the CPA Canada Public Sector Accounting Handbook, as amended from time to time.

a for-profit entity, a direction to consider factors identified in Part II of the CPA Canada Handbook.

23 Certain disclosures apply of the controlled entities, irrespective of the accounting applied. For the entity's NFP controlled entities, this includes a description of the relationship and the nature and extent of any economic interest that the reporting entity has in the controlled entity, and a 'clear and concise' description of the controlled entity's purpose, its intended community of service, its status under income tax legislation and its legal form.

New Zealand

24 The New Zealand accounting standard applying to NFP entities of the size contemplated by the AASB, *Public Benefit Entity Simple Format Reporting – Accrual (Not-For-Profit)* (PBE SFR-A (NFP)) (NZ Tier 3 reporting requirements) requires, in general, a NFP entity controlling another entity to prepare a consolidated performance report which combines the assets, liabilities, net assets/equity, revenue and expenses of the controlling entity with those of the controlled entity in accordance with the requirements specified by New Zealand accounting standards PBE IPSAS 35 *Consolidated Financial Statements* and PBE IPSAS 38 *Disclosure of Interests in Other Entities*. Under PBE IPSAS 35, an exemption and exception from consolidation are available if certain conditions are met. Broadly, these conditions are consistent with the conditions that must be met to qualify for exemption from consolidation under IFRS 10 *Consolidated Financial Statements* (entity is itself a subsidiary of a parent preparing IFRS compliant financial statements, or is an investment entity).

25 Basis for Conclusions paragraph BC17.2 of the PBE SFR-A (NFP) explains that the NZASB "… considered and rejected a disclosure only approach on the grounds that this would not result in an entity reporting the reality of its structures and arrangements. The NZASB was of the view that if a Tier 3 not-for-profit entity has interests in other entities, those interests need to be appropriately accounted for in the performance report. The NZASB considered that the Tier 2 PBE Accounting Standards contain appropriate accounting requirements for accounting for significant interests in other entities and that those requirements should also apply to any Tier 3 not-for-profit entity with such interests in other entities.". In addition, having regard to an observation that the development of simplified group accounting requirements would be difficult to draft and would significantly increase the size of a Tier 3 NFP standard, thereby detracting from the usefulness of the standard, the NZASB decided to give effect to its decision to require a Tier 3 NFP entity to account for significant interests in other entities in accordance with the Tier 2 PBE Accounting Standards by cross-reference from the PBE SFR-A (NFP) to the Tier 2 PBE Accounting Standards.[10]

26 A further differential reporting Tier applies to the smallest New Zealand NFP entities (Tier 4). New Zealand accounting standard *Public Benefit Entity Simple Format Reporting – Cash (Not-For-Profit)* (PBE SFR-C (NFP)) (NZ Tier 4 reporting requirements) may be applied by a New Zealand PBE NFP entity that has had, for the two preceding accounting periods, operating payments below NZD125,000 – such entities are outside the size boundary contemplated by the AASB in respect of its Tier 3 entity. However, of note is that the Standard does not require eligible parent entities to present consolidated financial statements.

27 Staff note that the NZASB is currently undertaking a post-implementation review of its Tier 3 and Tier 4 reporting requirements. The common themes from a high-level summary of the

10 Reference: PBE SFR-A (NFP).BC17.3 – BC17.4

outreach feedback did not identify the requirement to consolidate all controlled entities as a concern.[11,12]

United Kingdom

28 UK Financial Reporting Standard FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* is based on the *IFRS for SMEs*, amended to apply to the general purpose financial statements and financial reporting of entities including those that are not profit-oriented. Section 1A of FRS 102 includes specific requirements that can be accessed by 'small entities',[13] which could be expected to include those entities of a similar size to that contemplated by the Board. As noted in Agenda Paper 3.1, a review of FRS 102 is expected to occur shortly.

29 Under the general provisions of FRS 102, a parent entity is required to present consolidated financial statements in which it consolidates all its investments in subsidiaries only if it is a parent at the year end. Exemptions from consolidation are available where:

(a) the parent is a 'small entity'. A parent entity that is a 'small entity' is not required to present consolidated financial statements as long as it is not an excluded entity[14] under the Small Companies Regime or Small Limited Liability Partnerships Regime. However, it can do so if it wishes; but see also the *Charities SORP* requirements below;

(b) the (non-listed) parent is a wholly-owned subsidiary of another entity, or majority-owned and the remaining owners have not denied the action;

(c) severe long-term restrictions substantially hinder the exercise of the rights of the parent over the assets or management of the subsidiary; or

(d) the interest in the subsidiary is held exclusively with a view to subsequent resale and the subsidiary has not previously been consolidated.

30 However, a charity subject to the UK Charities Act 2011 may not be able to fully take advantage of the 'small entity' provisions set out in FRS 102. That legislation limits which charitable organisations can take advantage of the 'small entity' provisions in FRS 102, such that parent charitable organisations of the Tier 3 size considered by the AASB will be required to present consolidated financial statements unless the parent is itself a subsidiary of another entity or is under certain consolidated gross income thresholds. [15]

31 In addition to FRS 102, UK charities are required to comply with the Charities Statement of Recommended Practice (Charities SORP). [16] The Charities SORP provides guidance for charities

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11 NZASB Public Meeting Papers May 2021, Agenda Item 5.2

12 Staff note that one submission to the NZ post-implementation review expressed concerns about the requirement to consolidate. That stakeholder considered the definition of control to be unworkable, and suggested a requirement to consolidate be replaced with recognition as an investment (measured at the net assets of the controlled entity, with the movement in such described as investment income), accompanied by better information about group relationships, and possibly, disclosure of the net assets and parent entity information.

13 Under the UK Companies Act 2006, a company is a small company if it meets at least 2 of the following conditions: (1) annual (group) turnover is not more than £10.2 million; (2) the (group) balance sheet total is not more than £5.1 million; or (3) the average (group) number of employees is not more than 50. The Charities SORP

14 A public company is an excluded entity.

15 Depends on the UK jurisdiction, e.g. England and Wales, consolidated gross income ≤ GBP1million; Scotland, consolidated gross income < GBP500,000; Northern Ireland, consolidated gross income ≤ GBP500,000.

16 Other SORPs that may apply to NFP private sector entities also exist, but are not included in this staff paper. For example, the *SORP: Accounting for Further and Higher Education* provides guidance for further education and higher education institutions in the United Kingdom. That SORP, rather than the Charities SORP, applies to a charity that is a further education or higher education institution. Similar to the Charities SORP, *SORP: Accounting for Further and Higher Education* provides guidance/tips beyond that included in FRS 102 on how to identify controlled entities in this sector.

on how to apply FRS 102, and may specify requirements additional to that FRS (e.g. in the form of restricted accounting policy choices, presentation of information, or additional disclosures). For example, the Charities SORP notes that FRS 102 does not specify how branches, 'linked charities' and 'connected charities' are to be accounted for, and it consequentially sets out requirements/guidance in this regard.

32 Amongst other matters, the Charities SORP confirms that a controlled special purpose entity must be included in the consolidated financial statements, and that dissimilar activities are not a reason for not consolidating a controlled entity. With respect to the FRS 102 exemption from consolidation in instances where severe long-term restrictions substantially hinder the exercise of the rights of the parent over the assets or management of the subsidiary; the Charities SORP clarifies that a charitable subsidiary must only be excluded when both its charitable objects and its beneficiary class are not concurrent with that of its parent.

33 The Charities SORP sets out limited guidance to assist charities in understanding when control as described by FRS 102 is present (in particular, how power and benefit might be demonstrated), including acknowledging that (1) a parent charity can exercise control through trusteeship, in which case the consolidated financial statements would show the total funds under the trusteeship of the parent charity; and (2) benefit may be evidenced by the entities sharing concurrent purposes. For the mechanics of consolidation, it refers users of the SORP back to FRS 102.

34 Staff note that in addition to FRS 102, there is further UK differential reporting permitted for 'micro entities' – these requirements are specified in FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*. While FRS 105 does not apply to UK 'charitable organisation' – such entities must comply with at least FRS 102 / Charities SORP – other UK NFP entities might be able to apply this Standard. Consistent with the 'small entity' provisions in FRS 102, FRS 105 does not require an entity to apply consolidation accounting to its subsidiaries (i.e. that is, consolidated financial statements are not required). Instead, FRS 105 requires an entity to account for its investment in a subsidiary at its cost of investment less any impairment, from the time the entity becomes a party to the contractual provisions of the financial instrument.

United States of America

35 Whether a US non-profit organisation is required to prepare financial statements varies depending on the governing regulation. A US non-profit organisation preparing financial statements prepares them in compliance with the accounting standards issued by the US Financial Accounting Standards Board (FASB). These pronouncements do not contain any differential accounting requirements applying to smaller NFP entities applying these standards.

36 The staff research suggests that at least some USA states require NFP entities of the Tier 3 entity size contemplated by the Board to prepare US GAAP-compliant financial statements.[17]

17 Staff limited their research to identifying whether audited financial statements needed to be prepared for regulatory purposes and the size of the entity such requirement applies to. As the financial statements must comply with the accounting pronouncements issued by the FASB (GAAP), from this, staff concluded that the FASB requirements apply to entities of the same size as that contemplated by the Board in this project. Staff formed their conclusion through review of state law requirements that allow the state to receive financial statements of a charitable organisation (staff reference: https://www.councilofnonprofits.org/nonprofit-audit-guide/state-law-audit-requirements, last updated December 2019). For example, the US states of Connecticut, West Virginia and Wisconsin appear to require a charitable organisation with contributions/ gross annual revenue (some exceptions) over USD500,000 to file audited financial statements. In addition, staff research suggests that audited financial statements may also be required by the federal regulator where the non-profit organisation spends USD750,000 of federal funding, or more (reference: https://www.councilofnonprofits.org/nonprofit-audit-guide/federal-law-audit-requirements).

Consequently, staff think US GAAP provides a relevant reference for this project, at least for certain topics.[18]

37 With respect to the accounting for controlled entities, staff's understanding is that, in general, the relevant FASB pronouncements require a not-for-profit entity to consolidate its controlled entities and present consolidated financial statements (reference: Topic 810 *Consolidation* and Topic 958 *Not-for-Profit Entities*).

Hong Kong

38 Many Hong Kong charities or other NFP entities incorporate as a Hong Kong limited company, whether limited by shares or by guarantee. The Hong Kong Companies Ordinance (Cap.622) requires all Hong Kong companies to prepare financial statements. Some entities, including those of the size contemplated by the Board of its Tier 3 entity, are able to prepare financial statements that comply with the *HKFRS for Private Entities* (consistent to *IFRS for SMEs*, except for income taxes) or the Hong Kong *Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard* (SME-FRF & SME-FRS).[19]

39 In general, the SME-FRF & SME-FRS requires a parent entity to consolidate all its controlled entities and present consolidated financial statements. However, exemptions from consolidation are available, including when:

(a) the entity is itself a wholly-owned subsidiary of another entity; or

(b) the inclusion of a subsidiary would involve expense and delay out of proportion to the value to members of the company (other conditions must also be met). The entity is required to provide details, including summarised financial information, about such excluded subsidiaries.

Possible approaches to explaining control identified in the IFRS4NPO Consultation Paper

40 In January 2021, the Chartered Institute of Public Finance and Accountancy (CIPFA) issued the IFRS4NPO Consultation Paper. The Consultation Paper identified and described various NFP-specific reporting issues, and sought feedback on proposed methods of addressing these issues. Amongst these was the issues of how to determine control and establish the boundary of the reporting entity.[20]

41 While not specific to entities of the size contemplated by the Board, the Consultation Paper described common problems NFP entities face in identifying which entities might be controlled (including branches). Many of these relate to the manner in which a NFP private sector might commonly operate (e.g. structure and relationships), and also the entity's ability to practically exercise control or compel another entity to provide it with information (refer Appendix B of this staff paper). The Consultation Paper proposed two alternative approaches by which the sector could be assisted and accounting quality improved, being to either:

(a) adopt a principles-based approach to control (consistent with existing Australian requirements), and develop application guidance to assist entities in determining whether control; and

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18 Staff consider that it may not always be a relevant reference because US GAAP is based on a framework that differs significantly to IFRS.

19 For more information, see: https://www.hkicpa.org.hk/en/Standards-and-regulation/Standards/Our-views/Standards-Interpretations-Guides-and-PN-Members-Handbook/Reference-Materials/SME-Financial-Reporting-Framework-and-Standard/smefrfre2019

20 Whether or not the reporting entity should consolidate all its controlled entities was not addressed as an issue in this phase of the IFRS4NPO project and thusly, in this Consultation Paper.

(b) adopt narrower criteria/ tests, such as the power to govern financial and operating policies of the entity, as a pragmatic method of assessing control. The Consultation Paper observed that such approach, consistent with the approach currently adopted by the existing *IFRS for SMEs*, could be less resource-intensive for small NFP entities.

42 The Consultation Paper posited that, under both of its suggested approaches, disclosure would be necessary of information to help users of the financial statements understand the structure, risks and impacts of any branches and other related entities of the NFP entity.

Feedback from Australian stakeholders

43 During August – October 2020, staff conducted preliminary targeted outreach on possible key elements of a differential reporting framework for NFP private sector entities. The feedback from this outreach (refer Appendix A) indicated that many of the stakeholders were concerned that continuing to require AASB 10 consolidation requirements in lower-tier general purpose financial statements is not a proportionate response to existing concerns. Stakeholders made comments consistent with those described in the paragraph immediately below.

44 The AASB NFP Project Advisory Panel met on 18 May 2021 (refer Agenda Paper 6.4). At that meeting, staff invited Panel members to comment on possible Tier 3 accounting simplifications for controlled entities. Staff takeaways from the discussion were that:

(a) some of the complexity in application of existing requirements:

(i) pertains to difficulties in identifying controlled entities, including because information is not available to the entity

(ii) results from preparer/auditor disagreement with some of the control conclusions illustrated in Appendix E of AASB 10 (Australian Implementation Guidance);

(iii) arises from a view that consolidated financial statements do not provide useful information to users of the financial statements in instances where there are distinct user groups that are interested only in distinct activities of the group (e.g. church activities versus the performance of a school established by that church); and

(b) management of some NFP Tier 3 entities may not use consolidated information in their decision-making on relevant activities; and

(c) Panel members were not comfortable with the idea that a larger NFP entity might have access to relief from consolidation, should the Board decide to amend existing requirements in this regard for Tier 3 general purpose financial statements but not – per its preliminary decision made at its February 2021 meeting – specify a Tier 3 reporting threshold.

Findings from AASB Research Reports

45 Staff considered whether prior AASB research provide useful input to the staff analysis, included findings providing support or otherwise for the Board to undertake a simplification exercise on consolidation accounting, and the form of that simplification. As part of staff efforts, staff will continue to consider whether there is other academic literature relevant to the topic.

46 Staff make the following observations:

(a) there is academic research indicating that donors are more interested in non-financial information, and that users may find 'simpler' audited financial statements to be more useful (AASB Research Report 16 *Financial Reporting by Non Corporate or Small Entities*, April 2021)[21]. Staff think this suggests some support for developing simpler accounting requirements that may produce a result better understood by users, even though such result may be less representative/ relevant of the 'true' financial position or performance of the entity;

(b) there is academic research suggesting that donors are more likely to acquire non-financial information and integrate it into their decisions, as indicated by their chosen donations being significantly correlated with such information. Financial efficiency measures, while acquired, were not found to be integrated into donor decision-making (AASB Research Report 16 *Financial Reporting by Non Corporate or Small Entities*, April 2021). Staff think this suggests that perhaps the 'lost' benefits of the most relevant information through 'simplified' reporting requirements will not be as 'costly' as it may first appear;

(c) there is academic research suggesting that donors appear to link accountability to a demonstration that the money donated to the charity has been spent appropriately according to the purpose of the charity (AASB Research Report 16 *Financial Reporting by Non Corporate or Small Entities*, April 2021). Staff think this suggests some support for consolidated financial statements, to the extent the entity that receives the donation (e.g. a 'building fund' that is a deductible gift registrant) is not the entity charged with the appropriate spend of those monies;

(d) the findings from AASB Research Report 13 *Parent, Subsidiary and Group Financial Reporting* (October 2019)[22] suggest that lenders and investor users rely on consolidated financial statements, use summary financial information about the parent entity, and require more information about subsidiaries than that presently included in consolidated financial statements for their decision-making, particularly if the subsidiary financial statements are not available. The research report suggested that there may be a case for not requiring subsidiary financial statements should more relevant information about the subsidiary be included in the consolidated financial statements.

    Whilst its research and findings relate to private sector for-profit entities, the research report observed "… the benefits for users of consolidation and other information pertinent to parent/subsidiary structures are considered to be equally relevant in relation to private sector not-for-profit entities and public sector entities." For example, staff note that while NFP private sector entities might not frequently enter into borrowing arrangements, it does occur (e.g., a church might enter into a mortgage with a financing institution to finance the purchase of land for its operations). Similarly, while the users of NFP financial statements are more likely to be donors rather than 'investors', it is possible that their information needs could be served by more information about the subsidiary entity within group financial statements. Staff think the findings from this report suggest that there is opportunity for simplification of consolidation requirements, through disclosure of better information to understand the entities in the group;

(e) AASB Research Report 11 *Review of Special Purpose Financial Statements: Large and Medium-Sized Australian Charities* (September 2019) observed that a very small number of charities (13 out of 407 large and medium charities) referred to the charity as a parent entity and 12 of those entities prepared consolidated financial statements as part of the special purpose financial statements. However, as noted by the report, since the number of charities sampled for consolidated financial statements is very low, it could not be concluded whether the results are representative for a larger population. Because more detailed data is now available, staff analysis of the ACNC AIS 2019 dataset indicates that, for the Tier 3 population considered by the Board, there are 185 parent entities

21 Link to AASB Research Report 16 *Financial Reporting by Non Corporate or Small Entities*

22 Link to AASB Research Report 13 *Parent, Subsidiary and Group Financial Reporting*.

preparing special purpose financial statements – however, it is unknown how many of these entities prepare consolidated financial statements. This suggests that the Board's decisions about the accounting for controlled entities has the potential to significantly impact at least this group of entities.

Simplification aspects for the accounting for controlled entities

47 Having regard to current practice, international literature, AASB research findings and feedback received summarised in paragraphs 16 to 46 above, staff think that there are three relevant possible 'simplification' aspects for the Board's consideration:

(a) **Simplification aspect 1:** whether, and if so when, a controlled entity should be consolidated – refer paragraphs 49 – 70;

(b) **Simplification aspect 2:** whether to provide more guidance on control – refer paragraphs 71 – 75; and

(c) **Simplification aspect 3:** whether to contain all requirements for the accounting for controlled entities within a Tier 3 pronouncement (assuming that the Board decides, per the staff recommendation in Agenda Paper 3.2, that Tier 3 requirements should be set out in a stand-alone pronouncement), or whether to require entities to refer to guidance and requirements set out in AASB 10.

48 This staff paper does not discuss whether all requirements for the accounting for controlled entities should be detailed within a Tier 3 pronouncement. This is because this relates to broader Tier 3 'mechanics' that the Board needs to first make a decision on (discussed as part of Agenda Paper 3.2). Consequently, for example, this staff paper does not analyse how the mechanics of Tier 3 consolidation requirements (if required) might be incorporated, or whether a Tier 3 NFP private sector entity should have regard to the guidance contained in Appendix E of AASB 10.

Simplification aspect 1: Whether a controlled entity should be consolidated

49 Having considered how other jurisdictions have approached this issue, staff think the Board could consider adopting one of the following approaches as the Tier 3 accounting requirement for controlled entities of the NFP private sector entity:

(a) Approach 1: maintain Tier 2 accounting requirements for controlled entities

(b) Approach 2: as a rebuttable presumption, permit a parent entity not to consolidate some or all of its subsidiaries, and require disclosure of further information about those unconsolidated controlled entities, including summary financial information – either:

(i) Approach 2A: only where the entity concludes that consolidation will involve 'undue cost or effort';

(ii) Approach 2B: at the option of the parent, without restriction.

(c) Approach 3: require a parent entity to prepare separate financial statements as its only financial statements, and to disclose information about all its unconsolidated controlled entities, including summary financial information.

Each Approach is discussed in more detail below, to a level reflective of the project stage as the development of a discussion paper that tests the Board's preliminary views as to the approach it should develop further as an exposure draft. Therefore, the discussion and analysis are not to a level commensurate with that necessary for an exposure draft.

50 <u>Other possible approaches</u>. Staff observe that there are other possible alternatives that the Board could consider, including:

(a) requiring the presentation of combined financial statements, rather than consolidated financial statements;

(b) allowing a parent entity to equity account its investments in controlled entities, rather than consolidate their results and financial position; or

(c) extending the exception and exemption from consolidation to additionally include an exception from consolidation for subsidiaries that are acquired and held with the intention of selling or disposing of it within one year from its acquisition date.

51 Staff have not suggested these possible alternatives for Board consideration for the following reasons:

(a) combined financial statements are not currently required, so this would be introducing a new requirement. Similarly, the equity accounting of controlled entities is not an existing (or former) accounting practice in Australia. Staff think such alternatives introduce complexity for users to understand the financial statements and further preparer costs to transition to a higher tier; and

(b) in the absence of information to the contrary, staff think instances of a subsidiary being acquired and held with the intention of selling or disposing of it within one year from its acquisition date occurring could be expected to be highly infrequent, and as such, provide very limited relief to NFP Tier 3 entities.

Further detail about the Approaches and Staff analysis

<u>Approach 1: Maintain Tier 2 reporting requirements for controlled entities</u>

52 Approach 1 proposes no accounting changes to the existing principles, and not developing any further guidance on control to assist application. This approach views the benefits of consolidated financial statements as being greater than their costs, including for entities of the Tier 3 size contemplated by the Board. It is consistent with practices in jurisdictions like Canada and the USA which, because there is no differential framework, require the same accounting to be applied by all entities preparing financial statements. It is also similar to the approach taken in the *IFRS for SMEs* and NZ practice, both of which would also require controlled entities to, in general, be consolidated (noting the *IFRS for SMEs* has slightly different exemptions from consolidation compared to IFRS 10 *Consolidated Financial Statements*).

53 In developing AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities*, the Board decided to continue to require the preparation of consolidated financial statements. This decision was made having regard to the research findings from AASB Research Report 13, which suggested that users found the consolidated financial statements useful for their decision-making. Basis for Conclusions paragraph BC119 of AASB 2020-2 *Amendments to Australian Accounting Standards – Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities* states "The feedback … provided further support to the Board's view that consolidated financial statements are essential to provide users with transparent and complete information about the financial position and financial performance of the group and the entities in the group."

54 Arguments in support of Approach 1 include:

(a) it provides transparent and relevant information to users, and emphasises the importance of consolidated financial statements for decision-making (as conveyed by the Conceptual Framework, and as supported by findings from AASB Research Report 13);

(b) it maintains consistency with Tier 1 and Tier 2 requirements; and

(c) it harmonises with New Zealand Tier 3 accounting requirements, which rejected a disclosure only approach on the grounds that this would not result in the entity reporting the reality of its structures and arrangements.

55 Arguments against Approach 1 include:

(a) it does not respond to stakeholder feedback that consolidation might obscure relevant information, as different user groups might be interested only in distinct activities of the group. (However, staff note that the UK Charities SORP explicitly comments that dissimilar activities of a charitable group is not a reason for not consolidating);

(b) it is not a proportionate response in acknowledgement of the disproportionate costs incurred by Tier 3-sized entities to identify controlled entities and prepare consolidated financial statements, noting stakeholder feedback about challenges faced by NFP entities in identifying controlled entities (see also (d) below), especially if benefits to users are limited if they are not specifically requesting information about the consolidated entity;

(c) various regulators currently accept unconsolidated financial statements of the parent (i.e. as special purpose financial statements that do not comply with AASB 10 are accepted), suggesting that management's accountability for stewardship of the entity might be sufficiently discharged through the provision of such financial statements. (This assumes that the regulator would have been lobbied against such acceptance, had users required consolidated financial statements);

(d) in general, individual group entities (other than the parent) must continue to lodge financial statements even where consolidated financial statements that incorporate their results are prepared. Consequently, interested users might be able to access information about the subsidiary through the subsidiary's individual financial statements if that information is relevant to the user's decision making.

<u>Approach 2: Permit a parent entity not to consolidate some or all of its subsidiaries, and to disclose information about those unconsolidated controlled entities, including summary financial information</u>

56 Approach 2 contemplates that changing consolidation requirements would be a proportionate response to this lower-differential reporting tier. This approach is similar to that of UK and Hong Kong practice, in that the requirement to consolidate is relaxed at a differential reporting level below of that equivalent to the *IFRS for SMEs* (UK: the accounting standard does not require consolidation but legislation for charities may require it; HK: consolidation is not required where it would involve expense and delay out of proportion to the value to members).

57 Similar to Approach 1, this Approach also considers information about the group's performance and financial position to be useful to users of the financial statements. However, this approach proposes that Tier 2 consolidation requirements are "relaxed" to allow for some subsidiaries to not be consolidated; that is, it proposes that relevant information may be provided through disclosure or through recognition and measurement. This Approach would require extended details about each unconsolidated subsidiary to be provided, including summarised financial information about the unconsolidated subsidiaries. This Approach takes the view that, with this additional information, contrary to the assertion in paragraph 3.18 pf the Conceptual Framework, information provided in unconsolidated financial statements may be sufficient to meet the information needs of the primary users of the financial statements of the parent.

58 Arguments in support of Approach 2 include:

(a) it is a proportionate response, noting that the costs of preparing consolidated financial statements (given identification and data collection challenges) is likely to exceed the benefits of that information, as information about the subsidiary that could allow recreation of the consolidated group position will be available and as academic research suggested that donors rely less on financial information compared to non-financial information about the entity to make their investing decisions;

(b) it acknowledges the preparer concern that consolidation might not provide useful information to users of the financial statements of a Tier 3 NFP private sector entity;[23]

(c) it reduces compliance costs by providing preparers with an option to substitute consolidation with disclosure, including in cases where the parent entity may find it difficult to obtain information from the subsidiary;

(d) arguably reduces user (interpretation) costs by enabling financial statements that are more relevant to be prepared, to the extent that the entity assesses that 'full' consolidated financial statements do not provide information that is useful to its users. (However, staff note that this concern could alternatively be addressed by the preparer through disaggregation or other improvement to the manner in which information is presented in consolidated financial statements – albeit increasing preparer preparation costs.);

(e) it mitigates the stakeholder concern that some 'controlled' entities are not in practicality controlled by the reporting entity. To the extent such entities are not consolidated, the 'mis-identification' of an entity as a subsidiary becomes less of import as the entity's results need not be reflected in the consolidated results and financial position of the reporting entity; and

(f) because summary financial information will be required under this approach, it will continue to require the collection of information that would allow the consolidated performance and financial position of the group to be reconstructed; consequently, the loss of information is minimised as this approach maintains a closeness to the reporting specified by a higher reporting Tier. The requirement to provide summary financial information about the unconsolidated subsidiary provides transparency to the accounting policy adopted, and may serve as an adequate response to Tier 3 user needs; and

(g) it is consistent with practice in (unconsolidated) special purpose financial statements submitted and accepted by at least some regulators. Acceptance of such unconsolidated financial statements suggests that there is not a large unaddressed user demand for consolidated financial statements.

59 Arguments against Approach 2 include:

(a) it mitigates, but does not 'solve', the stakeholder concern that the 'wrong'/inappropriate entities are identified as controlled entities;

(b) it does not improve comparability between entities, as different entities may make different consolidation choices in respect of subsidiaries of a similar nature;

(c) there will be reduced comparability with entities complying with Tier 1 or Tier 2 reporting requirements;

23 The Issues Paper: Better Financial Reporting for Australian NFPs (March 2018) issued by the Independent Centre for Applied Not-for-Profit Research reported the following: "Stakeholders have raised concerns with regard to apparently unintended consequences associated with the application of AASB10. For instance, sovereign NFPs and Charities that have historically-based governance structures (such as those related to churches and their auspiced social service organisations) may imply control has been achieved and consolidation is required. However, while there may well be a relationship and shared objectives between a church and its auspiced entities, it does not necessarily follow that consolidation will result in a better Financial Reporting outcome, especially if there is no shared financial liability or some other financial impact. Indeed, the performance of the charity may be lost in this process, making the report less useful to the user – viability and solvency of individual organisations may not be discernible and funders and others may be misinformed. This is especially an issue in the case of many church-based organisations where the auspicing church has no responsibility for the financial outcomes of auspiced entities. …"

(d) it could be mis-used by some entities to avoid headline revealing the ‘true’ financial position and financial performance of the economic entity, which could be relevant for solvency and future grant funding assessments. (However, staff note that users concerned about solvency and asset claims are more likely to have regard to the financial position and performance of the legal entity, rather than the economic entity);

(e) it could be seen as not an adequate improvement over the quality of special purpose financial statements, as although more disclosure about the entity’s controlled entities may be required, the entity is able to avoid presenting consolidated financial information (which is generally accepted as being of higher-quality than merely disclosure);

(f) it introduces complexity/confusion for users by not requiring all controlled entities to be consolidated;

(g) some legislation currently refers to consolidated amounts (e.g. revenue or assets) for the purposes of identifying the entity’s reporting obligations. To avoid unintended consequences, this approach may require legislation to be amended to draw a distinction between consolidation for the purposes of this test, and consolidation for the purposes of the general purpose financial statements;

(h) to the extent that a departure from consolidation is only permitted where management determines doing so would involve ‘undue cost or effort’, this approach introduces further subjectivity (and therefore, complexity) into the accounting policy decision;

(i) creates an apparent inconsistency with AASB 127, which recognises separate financial statements as being those prepared in addition to consolidated financial statements; and

(j) reduced harmonisation with New Zealand entities of a similar size, as NZ Tier 3 reporting requirements require the consolidation of controlled entities.

60 Staff proposed alternative Approach 2A and Approach 2B. Approach 2A would require the entity to demonstrate the consolidation exercise for a subsidiary would involve ‘undue cost or effort’, while Approach 2B allows the choice of consolidation or disclosure without justification. Staff think that both approaches are likely to lead to the same result in practice, however, observe that Approach 2A requires some rigour around the management decision rather than merely an ‘easiest requirement’ decision. Staff think that ‘undue cost or effort’ should be interpreted as set out in the *IFRS for SMEs*, i.e. that it requires consideration of both e.g. employee efforts as well as how the economic decisions of those that are expected to use the financial statements could be affected by not having that information (a cost-benefit analysis).

<u>Approach 3: Require a parent entity to prepare separate financial statements as its only financial statements, and to disclose information about all its unconsolidated controlled entities, including summary financial information</u>

61 This approach proposes that only separate financial statements are prepared, but that information additional to that currently specified by AASB 127 *Consolidated and Separate Financial Statements* be required to provide a depiction of the financial position and performance of the economic entity. This approach takes the view that with this additional information, contrary to the assertion in paragraph 3.18 of the Conceptual Framework, information provided in unconsolidated financial statements may be sufficient to meet the information needs of the primary users of the financial statements of the parent.

62 Arguments in support of this Approach include those identified in paragraph 58 above noting that the potentially further cost savings related to the consolidation procedures under this Approach compared to Approach 2.

63 Arguments against this Approach include (consistent with those identified in paragraph 59 above):

(a) it mitigates, but does not ‘solve’, the stakeholder concern that the ‘wrong’/inappropriate entities are identified as controlled entities;

(b) there will be reduced comparability with entities complying with Tier 1 or Tier 2 reporting requirements;

(c) it could be seen as not an adequate improvement over the quality of special purpose financial statements, as although more disclosure about the entity’s controlled entities may be required, the entity is able to avoid presenting consolidated financial information (which is generally accepted as being of higher-quality than merely disclosure);

(d) some legislation currently refers to consolidated amounts (e.g. revenue or assets) for the purposes of identifying the entity’s reporting obligations. To avoid unintended consequences, this approach may require legislation to be amended to draw a distinction between consolidation for the purposes of this test, and consolidation for the purposes of the general purpose financial statements;

(e) creates an apparent inconsistency with AASB 127, which recognises separate financial statements as being those prepared in addition to consolidated financial statements;

(f) reduced harmonisation with New Zealand entities of a similar size, as NZ Tier 3 reporting requirements require the consolidation of controlled entities.

<u>Investment entity exception</u>

64 Staff note that IASB is considering, as part of its project reviewing the *IFRS for SMEs*, whether to amend the Standard to incorporate the investment entity exception from consolidation. The exclusion of such exception is a potential ‘simplification’ that the Board could make. Staff have not discussed whether this exception should be retained in Tier 3 reporting requirements at this time, as this decision may not be necessary depending on the Approach for the accounting of controlled entities elected by the Board.

<u>Principles for forming the Board’s views on Tier 3 accounting requirements</u>

65 In addition to analysing arguments for and against the proposed Approaches, staff considered the consistency of the proposed Approaches against the Board’s principles for forming its views on Tier 3 accounting requirements.

66 At its 20-21 April 2021 meeting, the Board agreed that the following principles will be used to form the Board’s views on Tier 3 accounting requirements:

(a) the development of Tier 3 reporting requirements is subject to the *AASB Not-for-Profit Entity Standard-Setting Framework*;

(b) Tier 3 financial statements are general purpose financial statements. As such, Tier 3 financial statements provide useful financial information to users of the financial statements;

(c) consistency with the accounting principles specified by Tier 2: Australian Accounting Standards – Simplified Disclosures is desirable, but might not always be warranted, since Tier 3 requirements are being developed as a proportionate response to the costs incurred by certain entities whilst still meeting the needs of users of the financial statements for this cohort of entities. For example, opportunities for deviation from Tier 2 accounting principles that could give a similar outcome to users while reflecting an appropriate cost/benefit balance could include disclosure requirements instead of a Tier 2 measurement requirement or an approach of specifying minimum ‘prescriptive’ disclosures;

(d) where possible within the context of its conceptual framework and user needs and cost/benefit considerations, in developing accounting requirements the aim is to maximise leveraging information that management uses to make decisions about the entity's operations; and

(e) accounting requirements do not impose disproportionate costs to preparers, when compared to benefits of the information.

67 The tables below set out staff's analysis of each of the proposed approaches against these principles:

Approach proposed	**Principle: The development of Tier 3 reporting requirements is subject to the AASB Not-for-Profit Entity Standard-Setting Framework**
Approach 1: Maintain Tier 2 requirements	Consistent with the AASB Not-for-Profit Entity Standard-Setting Framework as it proposes no changes to Tier 2 requirements in relation to the consolidation of controlled entities.
Approach 2: Permit disclosure about (unconsolidated) controlled entities to replace consolidated information	Consistent with the AASB Not-for-Profit Entity Standard-Setting Framework, as the Framework permits modification from IFRS where necessary to address undue costs or effort considerations. Having regard to the contemplated Tier 3 entity size and by extension, resources, staff think that requiring consolidated financial statements to be prepared where consolidated information is not already used by management will otherwise result in disproportionate costs to the entity to interpret and apply existing consolidation requirements, given the apparent lack of users for those financial statements and the proposal that user needs be met through the provision of summary financial information about each unconsolidated subsidiary. This might especially be the case where relevant legislation does not refer to the entity's consolidated results/position for the purposes of identifying its financial reporting obligations (i.e. there is not already a reason for the entity to incur costs related to undertaking the consolidation exercise).
Approach 3: Require only separate financial statements to be presented, supplemented with information about the (unconsolidated) controlled entities	As per Approach 2.

Approach proposed	**Principle: Tier 3 financial statements are general purpose financial statements. As such, Tier 3 financial statements provide useful financial information to users of the financial statements**
Approach 1: Maintain Tier 2 requirements	Consistent with the objective of general purpose financial statements, as the application of IFRS-compliant requirements is presumed to result in useful financial information.
Approach 2: Permit disclosure about (unconsolidated) controlled entities to replace consolidated information	Consistent with the objective of general purpose financial statements, as meaningful financial information about the economic entity will be provided to users of the financial statements, albeit in a different form and potentially requiring more interpretation effort on the part of the user. Currently accepted financial statements forms and the initial stakeholder feedback suggests that stakeholders may not find consolidated financial information to be all that useful. (Note: Staff think that the Conceptual Framework for Financial Reporting allows for 'useful financial information' to be provided in more than one manner; that is, a non-IFRS-consistent accounting requirement may still provide relevant and faithfully representative financial information.)
Approach 3: Require only separate financial statements to be presented, supplemented with information about the (unconsolidated) controlled entities	As per Approach 2

Approach proposed	**Principle: Consistency with the accounting principles specified by Tier 2: Australian Accounting Standards – Simplified Disclosures is desirable, but might not always be warranted, since Tier 3 requirements are being developed as a proportionate response**
Approach 1: Maintain Tier 2 requirements	Consistent with the accounting principles specified by Tier 2, but which might not be desirable; noting that some other jurisdictions do not require the consolidation of controlled entities at this level of its differential reporting framework.
Approach 2: Permit disclosure about (unconsolidated) controlled entities to replace consolidated information	This Approach maintains a level of consistency with the accounting principles specified by Tier 2, as consolidation is permitted (or possibly required except where it involves undue cost or effort). Departure from Tier 2 accounting principles is warranted in light of the costs versus the benefits of that information, noting that information is not altogether 'lost' as the provision of summarised financial information should allow interested users to reconstruct the consolidated result and financial position of the economic entity.
Approach 3: Require only separate financial statements to be presented, supplemented with information about the (unconsolidated) controlled entities	This Approach is not consistent with the Tier 2 accounting principles for controlled entities. However, consistency is not warranted in light of the costs versus the benefits of that information, noting that at least some regulators do not currently require the provision of consolidated financial information suggesting that there is not a large user demand for such financial statements. Consequentially, staff think the requirement to provide summary financial information in place of the consolidated financial statements is an appropriate proportionate response at this differential reporting level.

Approach proposed	**Principle: Where possible within the context of its conceptual framework and user needs and cost/benefit considerations, in developing accounting requirements the aim is to maximise leveraging information that management uses to make decisions about the entity's operations**
Approach 1: Maintain Tier 2 requirements	As this Approach does not suggest any changes to the Tier 2 requirements for application in Tier 3 general purpose financial statements, it should leverage financial information that management uses to make decisions about the entity's operations. However, it may require management to collect information in addition to that it may use to make decisions about the entity's operations, to the extent that consolidated information is not used by management for decision making.
Approach 2: Permit disclosure about (unconsolidated) controlled entities to replace consolidated information	Staff think this Approach best leverages information that management uses to make decisions about the entity's operations, as this approach accords entities the opportunity to provide users with consolidated financial information at a level more consistent with that used in management decision-making. However, it may require management to collect information in addition to that it may use to make decisions about the entity's operations, to the extent that consolidated information about some controlled entities is not used by management for decision making.
Approach 3: Require only separate financial statements to be presented, supplemented with information about the (unconsolidated) controlled entities	Staff think this Approach does not leverage information that management uses to make decisions about the entity's operations. This is because this Approach views the entity's interests in controlled entities as little more than an investment, or of less relevance to the user.

Approach proposed	**Principle: Accounting requirements do not impose disproportionate costs to preparers, when compared to benefits of the information**
Approach 1: Maintain Tier 2 requirements	Having regard to challenges in identifying controlled entities and applying consolidation procedures, staff think, on balance, that this Approach imposes disproportionate costs to Tier 3 preparers when compared to the benefits of that information. Staff think the limited benefits of that information is demonstrated by the acceptance by at least some regulators of unconsolidated financial statements.
Approach 2: Permit disclosure about (unconsolidated)	Staff think that this Approach does not impose disproportionate costs to preparers, when compared to benefits of the information

controlled entities to replace consolidated information	
Approach 3: Require only separate financial statements to be presented, supplemented with information about the (unconsolidated) controlled entities	Staff think that this Approach does not impose disproportionate costs to preparers, when compared to benefits of the information. This is because preparer costs are reduced as there is no requirement to present consolidated financial statements. However, users continue to benefit from having information about the subsidiaries through summary financial information, which might have otherwise been obscured in the consolidated financial statements. Of the 3 approaches proposed, staff think that this Approach least imposes costs to preparers, when compared to benefits of the information. This is because it does not require any accounting policy decision making.

Staff view

68 Having regard to discussion and analysis set out in paragraphs 52 – 67 above, on balance, staff support Approach 2. That is, that the proposed Tier 3 reporting requirements require the following:

(a) the consolidation of controlled entities should be allowed, but not required. This decision should be made with respect of each controlled entity and should not change from period to period, except where there is a justifiable reason for the change; and

(b) the financial statements should include further information to help users understand the accounting for the economic entity, including summarised financial information of each controlled entity for which the results and financial position have not been consolidated as part of the prepared financial statements.

69 Staff think that the suggested reporting requirements above represent a proportionate response for Tier 3 reporting requirements, as they provide a level of significant distinction between Tier 2 and Tier 3 reporting requirements in recognition of the cost/user needs balance, whilst alleviating some of the preparation complexity faced by preparers.

70 However, staff have mixed views as to whether the availability to not consolidate should be restricted. Some staff support Approach 2B over Approach 2A (i.e. no restriction) while other staff support Approach 2A over Approach 2B (i.e. consolidate, subject to an ‘undue cost or effort’):

(a) The staff supporting Approach 2B consider that the cost/benefit decision is best a determination of the standard-setter, not the preparer. These staff also think that leaving such decision to the preparer is inconsistent with the more recent elimination from AASB 9 of the notion of an “impractical out” (allowing cost as a proxy for fair value) or the “true and fair override” from the Australian accounting standards (AASB 101.19 and Aus19.1). Staff also think that the ‘undue cost or effort’ criterion is unlikely to result in a practical difference;

(b) Approach 2A is based on the view that ‘full’ consolidated financial statements provide the most useful information to users of the financial statements, and that consequently, a departure from that position must be justifiable, rather than being an unrestricted choice. Staff supporting this approach observe that parent entities that currently avoid preparing consolidated financial statements (through preparing special purpose financial statements) may already implicitly make this cost/benefit assessment, and therefore that restricting the availability in this regard may not change practice, but will force the reporting entity to justify its decision, demonstrating accountability. Staff supporting Approach 2A also point to AASB 108, which contemplates an impractical out from retrospective restatement of errors and accounting policies.

Question for Board members

Q1 Do Board members support, for the purposes of the discussion paper, the proposal that Tier 3 reporting requirements require the following:

(a) the consolidation of controlled entities should be allowed, but not required. This decision should be made with respect of each controlled entity and should not change from period to period, except where there is a justifiable reason for the change;

(b) the financial statements should include further information to help users understand the accounting for the economic entity, including summarised financial information of each controlled entity for which the results and financial position have not been consolidated as part of the prepared financial statements?

Q2 If Board members support the proposal in Q1, do Board members support allowing the entity a further exemption from consolidation without restriction (Approach 2B) or to allow this only in instances involving undue cost or effort (Approach 2A)?

Simplification aspect 2: Whether to provide more guidance on control

71 Staff's initial outreach suggests that NFP private sector preparers continue to find it challenging to identify the entity's controlled entities, and in some cases, consider AASB 10 to result in inappropriate identification of an entity as a 'subsidiary'. Hence, the question arises as to whether the Board should 'simplify' by developing more guidance to help Tier 3 NFP private sector entities to assess whether control exists, especially in instances where the ownership interest may not be reflective of control.

72 Staff recommend that this not be addressed as part of this project as the stakeholder concern that control as currently interpreted/implemented might not produce financial statements that are useful or appropriately representative is a concern that applies to all NFP private sector entities, not just Tier 3 NFP private sector entities. Staff think that this concern should instead be considered as part of the post-implementation review of AASB 10.

73 Similarly, the Board could consider whether to 'simplify' control decisions by specifying a set of objective criteria that must be present for control to exist, thereby removing subjectivity (and complexity) from the process. This is consistent with the approach taken by the *IFRS for SMEs* and would provide more clarity (and consequently, reduce costs) for preparers.

74 Staff recommend that this 'simplification' action not be taken for the following reasons:

(a) it is a departure from principles-based standard-setting and the notion of substance over form;

(b) it could create potential differences from the conclusion drawn at a different reporting Tier;

(c) the IASB's review of the *IFRS for SMEs* indicated stakeholder support for aligning the definitions of control between the *IFRS for SMEs* and IFRS 10;

(d) to the extent control is not via an ownership interest, it might be difficult to develop suitable criteria; and

(e) the preliminary stakeholder feedback did not reveal any issues with consolidation being based on a notion of control but rather, a concern that AASB 10 control as currently interpreted/implemented might not produce financial statements that are useful or appropriately representative.

75 Staff had regard to the principles for forming Tier 3 reporting requirements. Staff consider that consistency with the accounting principles specified by Tier 2: Australian Accounting Standards – Simplified Disclosures is desirable and warranted in this regard, as the costs to preparers might only be reduced to the extent the Board is able to develop suitable criteria that is applicable and appropriate to a broad range of NFP private sector entities. Staff also think that if the Board supports Approach 2 or Approach 3 to the accounting for controlled entities, the establishment of whether control is present may be less of an issue. Consequently, staff do

not think the costs of applying the existing control principle requirements exceed the benefits of that information, and accordingly, do not recommend any change in this regard.

Question for Board members

Q3 Do Board members support, for the purposes of the discussion paper, the proposal that Tier 3 reporting requirements:

(a) do not include more guidance to help Tier 3 NFP private sector entities to assess whether control exists;

(b) do not specify a set of objective criteria that must be present for control to exist?

Related issues

76 In addition to considering the accounting for controlled entities, staff think it may be relevant for the Board to also develop high-level views as to whether, and if so, what 'simplification' is necessary on the related topics of the accounting for an investor's interests in an associate or joint arrangement, and the accounting for a business combination. Staff think it is relevant also to consider whether it is necessary for the Board to address the accounting for its controlled and related entities in separate financial statements. Staff discuss these topics in paragraphs 77 – 84 below.

Possible Tier 3 requirements for associates and joint arrangements

77 Staff are not aware of any Australian stakeholder concerns with the accounting requirements for associates and joint arrangements. For this reason, staff think the Board should continue to require Tier 3 accounting requirements for such investments as part of Tier 3 reporting requirements, except if the Board forms a preliminary view to support Approach 3 for its controlled entities (consolidated financial statements are not required). In such cases, staff think the accounting for associates and joint arrangements should be aligned with that Board decision.

Question for Board members

Q4 Do Board members support, for the purposes of the discussion paper, the proposal that Tier 3 reporting requirements require an investor's investments in associates and joint arrangements to be accounted for in a similar manner to Tier 2 reporting requirements, except if the Board forms a preliminary view not to require consolidated financial statements to be prepared? Or, does the Board want to direct staff to perform more work in this regard?

Possible Tier 3 simplification for separate financial statements

78 The accounting requirements for separate financial statements, where prepared, are contained in AASB 127 *Separate Financial Statements*. These require the investment in subsidiaries, joint ventures and associates to be accounted for either at cost less impairment[24], in accordance with AASB 9 (i.e. at fair value), or by using the equity method. Exceptions apply where the investor is an investment entity, venture capitalist or similar entity. Staff observe that the IASB's Agenda Consultation Request for Information listed Separate financial statements in the financial reporting issues that could be addressed in a potential project.

79 As noted in paragraph 13 above, some legislation requires separate financial statements to be presented, while other legislation does not. Previous AASB research and outreach activity have not suggested that preparers have any concerns with the accounting for investments in group entities in separate financial statements. However, staff think, for simplicity, the Board

24 Paragraph 4 of AASB 136 *Impairment of Assets* clarifies that impairment requirements apply to financial assets classified as subsidiaries, joint ventures, and associates [AASB 136.4]

could limit the available accounting policy options, and instead require all such investments to be recognised at cost less impairment, unless investment entity or venture capitalist exceptions apply.

80 Staff think both maintaining the requirements specified by AASB 127 or limiting the requirement to a single accounting policy are consistent with the Board's principles for developing Tier 3 reporting requirements. However, limiting the available accounting policies to a single option that could reasonably be expected to be the most common accounting policy currently adopted, could arguably provide better clarity and direction for Tier 3 preparers, and so, further reduce preparer costs (as it removes the need for the preparer to decide an appropriate accounting policy). Consequently, staff recommend the Board adopt this as its preliminary view subject to the decisions the Board will make on the recommendations in Agenda Paper 3.2.

81 Staff have not proposed fair value or the equity method as the single accounting policy. This is because such requirement is more costly to prepare than measuring the investment at cost. Staff expect, for example, that the investment would generally be in an unlisted controlled entity for which it may be difficult to establish a fair value in accordance with AASB 13 *Fair Value Measurement*.

Question for Board members

Q5 Do Board members support, for the purposes of the discussion paper, the proposal that Tier 3 reporting requirements require an entity to measure its investments in controlled entities, associates and joint ventures in separate financial statements, where prepared, at cost less impairment? Or, does the Board want to direct staff to perform more work in this regard?

Possible Tier 3 simplification for the accounting for a business combination

82 Previous AASB research and staff's initial outreach on Tier 3 reporting requirements have not identified a concern with the requirements of the acquisition method of accounting for a business combination. It is also unclear how frequent business combinations occur in the NFP private sector for entities of the size contemplated by the Board.

83 For this reason, although there are recognition and measurement opportunities for simplification reducing costs (e.g. under US GAAP, NFP entities are not required to recognise separately from goodwill noncompetition agreements, and customer-related intangible assets unless they can be sold or licensed independently from other assets of a business), staff propose the Board retain the same accounting requirements for a business combination as applies to its other reporting Tiers. Staff think that, in general, the mechanics of accounting for an acquisition should not be amended in recognition of the size of the entity undertaking the acquisition.

Question for Board members

Q5 Do Board members support, for the purposes of the discussion paper, the proposal that Tier 3 reporting requirements require an entity to account for a business combination in a similar manner to Tier 2 reporting requirements? Or, does the Board want to direct staff to perform more work in this regard?

84 Agenda Paper 3.2 discussed how the Board might approach incorporating Tier 2 accounting requirements as part of a Tier 3 pronouncement. Consequently, this paper does not address this matter.

APPENDIX A Preliminary feedback received from initial targeted consultations with stakeholders conducted during August – October 2020

The following table is an extract from the staff summary of preliminary feedback received from its initial targeted consultations with stakeholders conducted during August – September 2020.[25]

[ ] have been added to clarify further some of the text in the table.

Matters discussed	Staff proposal of possible design	Initial feedback received from staff of federal, state and territory regulators and Project Advisory Panel members
Reporting tier threshold determinant	Consolidated revenue to determine the size of the entities and consequently the reporting requirements	… Staff of regulators expressed mixed views on using consolidated revenue as tier threshold: • [One] mentioned the current use of consolidated revenue or income as their primary tier threshold in their jurisdiction and therefore did not object to the staff proposals. • One [state regulator] confirmed its current practice requires consolidation if the reporting entity controls other entities, even though its reporting threshold is not explicitly referred to as "consolidated revenue". • Others currently require the size to be determined and financial reports to be prepared on a single entity basis and therefore expressed concerns. …
Consolidation	Mandatory application of AASB Tier 2 consolidation, equity accounting for investments in associates and joint ventures (JV) requirements (not required to apply full framework)	Staff of regulators also had significant concern with the proposed requirement for consolidation for middle tier entities. Some stakeholders expressed concerns around the proposed consolidation requirement for middle tier entities. ['Middle tier' references simple format accrual accounting based on NZ PBE NFP Tier 3 reporting requirements] • staff of one regulator (based on the feedback from their constituents) indicated the sector found it difficult to apply the consolidation accounting and many NFP entities' organisation structures do not naturally fit into the "control" definition in AAS. • staff of one regulator commented that many of the NFPs are small and unsophisticated community groups and the accounting requirements should not overburden them. • staff of one regulator noted that many NFP organisation structures do not naturally fit into AASB 10's "control" definition. • one panel member pointed out that for some NFP groups (i.e. where control exists), entities within the group may have different charitable purposes and separate user groups. There was concern that consolidation would deprive the separate user groups the clear reporting at the single entity level. The panel member said the proposed consolidation requirement would be the largest concern for many of their clients who currently prepare SPFS without consolidation, due to the cost of consolidation. • another panel member, however, believed that NFP entities have 'public accountability' in the sense that their operations rely on public funding. To discharge this 'public accountability', they should prepare consolidated financial statements (where relevant) and make available the separate financial statements of individual entities within the group. • staff of one regulator urged the AASB to consult widely with stakeholders to understand the issues with the mandatory application of full consolidation and equity accounting within the NFP private sector. …

No further feedback on consolidation was received during the September – October 2020 outreach.

[25] The complete staff summary was included as part of Agenda Paper 5.1 of the AASB 16-17 September 2020 Meeting. Link to Agenda Paper 5.1 of the AASB 16-17 September 2020 Meeting

APPENDIX B: Extract from IFR4NPO Consultation Paper[26]

The following text is an extract from Section 1: Reporting Entity of the IFR4NPO Consultation Paper. It describes the issue and financial reporting challenges faced by NFP entities when identifying the boundary of the reporting entity.

Issue 1: Reporting entity and control (including branches)

1. Description of the issue

1.1 ***Transparency improves comparability between similar types of NPOs that have different operating structures.*** *Full transparency and accountability over the assets and liabilities of NPOs is critical to financial reporting. Users need to know which activities are part of the reporting entity and the critical relationships with other entities.*

1.2 ***NPOs may have complex organisation structures to deliver their objectives.*** *NPOs often operate across multiple geographical areas. NPOs can supply a similar service to different areas of the same jurisdiction, or on an international basis, supply services to other jurisdictions. Activities that take place across a range of locations may be organised through a series of separate offices. Alternatively, assets, staff and/or resources may be formally allocated to a specific activity within an entity.*

1.3 ***Activities may not be delivered through a common model.*** *Activities may be delivered through separate legal entities or in partnership with another entity. Also, service recipients or supporters of an NPO may form entities to partner with and/or support an NPO.*

1.4 ***Many NPOs operate through a system of 'branches', with a branch being an internal structure created to carry out activities.*** *Branches are part of an NPO's operating structure and may be established to provide specific arrangements in a locality. They may also be used for fundraising. Branches may have their own bank accounts, with funds raised for specific local projects.*

1.5 ***NPOs can appear similar to the public but require different financial reporting arrangements.*** *NPOs may have service arrangements with local offices that are separate reporting areas, within an NPO. These reporting areas could have their own differing financial reporting arrangements. NPOs could also have service arrangements with other entities controlled by an NPO and insist on uniform activities and financial arrangements consistent with an NPO's central requirements. A range of examples include a local organisation affiliating with an NPO's national brand to benefit from logos, insurance etc, but maintaining its own financial and governance arrangements. Recognising these local organisations as a reporting entity can help internal decision making in respect of assets and liabilities (ie resources and potential risks).*

1.6 ***NPOs can face practical issues in producing their financial statements.*** *For example, an NPO may experience resistance to controls over local organisations (including branches) provided by legal powers. Branches may resist requests by an NPO and not submit financial returns or provide other information. Enforcement activities may not be worthwhile where individual branches are immaterial to the parent NPO's accounts.*

1.7 ***Determining whether an activity or branch is a separate reporting entity is often not easy.*** *The nature and complexities of the relationships that exist may make it challenging to decide when an activity or branch is part of an NPO, when it is part of a separate standalone reporting entity, or when it is part of a separate reporting entity controlled by an NPO.*

26 A copy of the IFRS4NPO Consultation Paper can be accessed from https://files.humentum.org/dl/tlwP5UUIiq (last accessed 7 June 2021).

1.8 ***Branches might not publicly report anywhere in the world because they are not included in any financial reports.*** *This might occur where a branch is not included, for example, in the accounts of its international based headquarters organisation and is also not considered a reporting entity in the jurisdiction that it is operating.*

1.9 ***Having trustees that are common across NPOs might raise questions about the relationship between NPOs.*** *This might occur where two NPOs with different operations have common trustees or a significant overlap in trustees. There are also questions where trustees have the ability to appoint trustees or board members in other related entities.*

2. Financial reporting challenges

2.1 ***NPOs need to follow the requirements of local regulators.*** *This may influence the way in which reporting entities are identified and subsequently treated in an NPO's financial reports.*

2.2 ***Different regulatory frameworks can exist within national jurisdictions for different types of NPOs as well as between them.*** *For example, a UK charity registered as a company follows requirements specified by the Companies Act 2006 while a social enterprise charity will follow the Charities Statement of Recommended Practice (SORP). The different frameworks may lead to different financial reporting outcomes for similar activities (although arguably in the UK these regulatory frameworks will lead to similar results for the majority of cases).*

2.3 ***NPOs may require substantial information and analysis to make judgements about control.*** *Determining the degree of control sufficient to recognise the assets and liabilities (and other resources) of a separate activity or reporting entity in the financial statements of an NPO may be challenging because of the nature of the relationships.*

2.4 ***There may be severe long-term restrictions that hinder control.*** *In some situations, the ability of one NPO to exercise rights over another may be limited. Alternatively, an entity may be held exclusively with a view to its subsequent resale. The identification of severe long-term restrictions requires a highly subjective assessment and may fluctuate wildly over relatively short periods of time.*

2.5 ***The definition of a reporting entity needs to be consistently applied.*** *There is a challenge in deriving definition of a reporting entity suitable for NPOs so that users get comparable information. The definition needs to be workable regardless of the way in which an NPO decides to operate. NPOs will need to ensure that decisions relating to control are consistent.*

2.6 ***Without additional disclosures it may not be clear what is included as part of an NPO (ie which, if any, branches are included) and which entities are controlled and form part of an NPO's financial statements.*** *The challenge involves the need to provide transparency, including the judgements being made to foster users' understanding of the reporting entity and the ability to assess comparability with other NPOs.*

The following table is also an extract from Section 1: Reporting Entity (page 85). The Table sets out the two approaches proposed to address the issue and challenges faced described above:

	Description	***Advantages***	***Disadvantages***
Alternative 1 *Prepare additional NPO-specific guidance on the nature of reporting entities and use the principles-based approach of substance over*	*Prepare additional NPO-specific guidance about how to identify a reporting entity including branches.* *• To determine control, use the three principles:* *• power over the entity*	***Technical*** *• Allowed by both IPSAS and IFRS and broadly consistent with the IFRS for SMEs Standard.* *• The specifications of benefits and relevant activities can be used to*	***Technical*** *• Additional guidance may have the effect of turning a principles-based approach into a rules-based approach.* ***Stakeholder***

form to define control.	*• exposure, or rights, to variable returns/benefits from its involvement with the other entity* *• the ability to use its power over the other entity to vary the returns/benefits.* *• Provide additional guidance on how to apply the principles for NPOs including how to specify relevant activities, ie those activities that significantly affect returns on a public benefits basis.* *• Provide guidance on disclosures to focus on structure, risks and impacts of branches and other related entities.*	*the determine control for NPOs.* ***Practical*** *• Principles provides flexibility to allow for variations in local environments.* *• Provides guidance on NPO-specific relationships and arrangements*	*• May impact comparability with other NPOs and entities in the public benefit and public sectors if there are different interpretations of the principles.* ***Cost/benefit*** *• The cost of determining whether control exists may outweigh the benefits, particularly for smaller entities.*
Alternative 2 *Prepare additional NPO-specific guidance on the nature of reporting entities and use pragmatic methods of assessment such as the power* *to govern financial and operating policies to define control.*	*Prepare additional NPO-specific guidance about how to identify a reporting entity including branches.* *• Establish supporting guidance based on a pragmatic approach to identify control. For example, the power to govern the financial and operating policies of an entity to obtain benefits from its activities, ie where through direct or indirect ownership more than half of the voting power is held).* *• Guidelines would be based on 'bright lines' tests eg voting rights. Substantive judgments, ie control of financial and operating policies and/or materiality would be required based on the guidance.* *• Provide guidance on disclosures to focus on structure, risks and impacts of branches and other related entities.*	***Technical*** *• Is currently consistent with the IFRS for SMEs Standard.* ***Practical*** *• May be easier to apply.* *• Provides guidance on NPO-specific relationships and arrangements.* ***Stakeholder*** *• May be easier for users to understand.* *• May improve comparability across NPOs.* ***Cost/benefit*** *• May be less resource intensive.*	***Technical*** *• Is not consistent with the principles-based approach in IFRS or IPSAS.* *• A pragmatic approach risks being unable to properly reflect the economic circumstances of an NPO's interests.* ***Practical*** *Might be difficult to arrive at a single set of pragmatic methods that meet the needs of the broad range of NPOs in the sector.*