



# Practitioner Advisory Group Issue Paper

AGENDA ITEM: PAGED05-3  
16 March 2021 – Online

## The Reporting Entity and Control (including Branches)

Summary	The paper focuses on key points on the consultation responses on the reporting entity and seeks PAG views on two areas for the proposed guidance.
Purpose/Objective of the paper	This paper explores aspects of the consultation feedback, where there was no consensus from respondents, particularly the approach to considering 'control'. This paper sets out the differences of views.
Other supporting items	N/A
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Actions for this meeting	<p><b>Provide advice on:</b></p> <ul style="list-style-type: none"><li>• the practical issues facing NPOs</li><li>• the advantages and disadvantages of a pragmatic approach.</li><li>• types of reporting structures used by NPOs</li></ul>

# Practitioner Advisory Group

## The Reporting NPO and Control (including branches)

### 1. Introduction

- 1.1 The report provides the following for the reporting entity and control (including branches):
- consideration of differing operating structures (including the views of respondents)
  - the views on respondents on the two alternatives for the definition of control
  - developments in relation to the comprehensive review of IFRS for SMEs and the definition of control
  - a summary of the relevant elements of the focus group on the reporting entity and control.

It seeks also views on whether there are any other typical structures where guidance should be developed and the best approach to the definition of control.

- 1.2 It also includes feedback from a focus group that was set up after the consultation paper responses. The focus group included 20 attendees, this including representatives from accounts preparers, auditors, standard setters, academics and accounting institutes. The focus group looked at:
- the description of the reporting NPO
  - the identification of the reporting NPO
  - identification of branches
  - the treatment of other structures and the reporting NPO, and
  - the proposed alternatives.

### 2. NPO structures

- 2.1 The Consultation Paper set out that NPOs can have complex organisation structures, which may mean different structures and/or services or functions being delivered using branches. Additionally, activities may be delivered through separate legal entities or in partnership with another entity. Service recipients or supporters of an NPO may form entities to partner with and/or support an NPO. All of these can lead to difficulties in identifying the reporting entity (NPO) and there are specific issues relating to branches.

- 2.2 For each of the issues in the consultation paper stakeholders were invited to comment on whether the paper had appropriately captured the issue ie the reporting entity and control including branches. 20 (71%) of responses agree with the description of the issue. Table 1 in Annex 3 provides an overview of the comments.
- 2.3 The Secretariat is developing guidance on differing operating structures and this includes a description of an internal branch (on the basis that some NPOs may be described as branches but be separate reporting entities). The Guidance also includes indicators that identify the existence of a branch using as its inspiration the Charities SORP in the UK.
- 2.4 The Guidance will also include different operating structures and the accounting treatment for these types of structures including:
- subscription and fee-based structures
  - NPOs established as separate legal entities to manage the financial burdens or the risks within the activities of the NPO or for fundraising activities, and
  - affiliated structures.
- This has been inspired by the New Zealand Explanatory Guide A8 Financial Reporting by Not-For-Profit Entities: The Reporting Entity (EG A8); New Zealand Accounting Standards Board, October 2014
- 2.5 PAG's views are sought on whether there are other typical structures that should be included, what are the main features of the structures might be and why they might need additional guidance.

**Question 1:**

PAG is invited to consider:

- whether there are other typical operating structures that may need to be considered in INPAG illustrative guidance?
- what are the features of the structures for which INPAG illustrative guidance needs to be developed?

**3. Alternative approaches to control**

*Approaches outlined in the Consultation Paper*

- 3.1 The Consultation Paper offered two main alternatives in relation to the topic of the reporting entity and branches:

- **Alternative 1:** this alternative uses the substance over form principles included in IFRS Standards and IPSAS (IFRS 10/IPSAS 35 *Consolidated Financial Statements*). It is based on the preparation of additional NPO-specific guidance, using a principles-based approach to determine whether one entity has control over another.
- **Alternative 2:** proposes the use of pragmatic methods of assessment such as the power to govern financial and operating policies to define control as required by the IFRS for SMEs Standard. This alternative would focus on key characteristics that define NPO relationships and use the control principles set out in IFRS 10 and IPSAS 35 to develop tests to determine control. This may be a more pragmatic approach, particularly for smaller NPOs than a potentially more resource intensive assessment using principles.

#### *Views of Respondents*

- 3.2 Respondents favoured alternative 2 ie the use of pragmatic methods of assessment such as the power to govern financial and operating policies to define control as required by the IFRS for SMEs Standard with 16 (62%) of respondents suggesting that they would prefer alternative 2 and 7 (27%) of respondents favouring alternative 1 (following the IFRS 10 definition of control) and 3 (12%) respondents not wishing to proceed with either alternative. Table 2 in Annex B provides an overview of the comments.

#### *Impact of the Comprehensive Review of IFRS for SMEs*

- 3.3 PAG members may be aware that in January 2020 the International Accounting Standards Board published a Request for Information (RfI) to seek views on whether and how to align the IFRS for SMEs Standard with full IFRS Standards. The RfI sought views on whether to amend the IFRS for SMEs Standard to align partially with IFRS 10. Among other decisions In December 2021 the IASB tentatively agreed to:
- align the definition of control in the *IFRS for SMEs* Standard with that in IFRS 10
  - retain and update the rebuttable presumption in paragraph 9.5 of the IFRS for SMEs Standard relating to the assessment of control.
- 3.4 The issue of the Exposure Draft for the IFRS for SMEs amendments is anticipated to be issued in the second half of 2022. This might mean that the amended standard will be issued towards the end of 2023. The IASB's tentative decision might mean that the more pragmatic approach to the definition of control will no longer be a part of international GAAP.



*Focus Group Feedback*

- 3.5 As the consultation feedback favoured using a standard that may only be extant for a short time, the focus group considered the issue in more detail. Focus group members were relatively evenly split between the two alternatives with similar arguments being presented to those who responded to the consultation.
- 3.6 Alternative 1 – IFRS 10 approach was deemed to be the better conceptual approach with respondents arguing that any issues requiring judgement could be dealt with by means of application guidance. Focus group attendees noted that this alternative was also better equipped to deal with control decisions that were not based on ownership. The Secretariat would largely agree with this commentary.
- 3.7 Alternative 2 (the pragmatic IFRS for SMEs approach) – supporters of this approach were clear that this approach was substantially easier to apply and easier to understand and that the decision-making process would use less resources. Their view was that alternative 1 would require more judgements to be made and that this would test capacity and resources in NPO's. Focus group members were concerned about capacity.
- 3.8 Views of PAG are being sought following the Consultation Paper's responses, the views of the focus group and given the risk that alternative 2 treatment will no longer be extant GAAP, particularly with regards to the main advantages and disadvantages to a more pragmatic approach to the definition of control to be.

**Question 2:**

PAG is invited to consider:

- a. the practical issues that might be experienced by an NPO?
- b. what the advantages and disadvantages of a pragmatic approach might be?

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Annex A - Issue 1: Reporting entity and control (including branches)

<b>Table (D)</b>	<b>Agree</b>	<b>Disagree</b>	<b>Neither Agree nor Disagree</b>	<b>Total Number of Responses to SMC</b>	<b>Non-Response</b>	<b>Total No. Responses</b>
SMC 1a) Do you agree with the description of issue 1 – Reporting entity and control (including branches) – in the Consultation Paper? If not, why not?	20 (71%)	6 (21%)	2 (7%)	28	41	69
SMC 1b) Do you agree that the list of alternative treatments that should be considered for issue 1 is exhaustive? If not, please describe your additional proposed alternatives, and explain why they should be considered.	20 (74%)	6 (22%)	1 (4%)	27	42	69
SMC 1c) Do you agree with the advantages and disadvantages articulated for each alternative accounting treatment for issue 1? If you do not agree, please set out the changes you propose, and why these should be made.	18 (69%)	8 (31%)	0	26	43	69



<b>Table D (ii)</b>	<b>Alternative 1</b>	<b>Alternative 2</b>	<b>None</b>	<b>Total Number of Responses to SMC</b>	<b>Nonresponse</b>	<b>Total No. Responses</b>
SMC 1d) Please identify the alternative treatment that you favour for issue 1, and the reasons for your view.	7 (27%)	16 (62%)	3 (12%)	26	43	69

Annex B

Table 1: SMC 1.a Description of the Issue

<p><i>Comments from respondents that agreed were as follows:</i></p>
<ul style="list-style-type: none"> <li>• Several respondents in the supporting commentary agreed that there is a need to define control in the NPO context.</li> <li>• The need to be clear about the description of branches ie that they are not a separate legal entity. The Guidance would also need to be flexible such that a part of a legal entity (this might be a branch) could be deemed to be a reporting entity, if necessary.</li> <li>• Four models identified by research in New Zealand including:             <ul style="list-style-type: none"> <li>- a 'top down' approach to their related entities which were managed by a Head Office</li> <li>- a 'bottom up' approach with complex inter-relationships and democratic governance resulting in a multitude of reporting entities</li> <li>- an 'affiliated members' approach where the Head Office was a separate entity and members operated independently</li> <li>- a final set of NPOs had 'related interests' but did not acknowledge this in their financial statements.</li> </ul> </li> <li>• Sometimes these structures may take different legal forms supporting examples would need to be able to accommodate these different operating structures.</li> <li>• NPOs are not owned and that the boundaries for NPO reporting entities is less clear and there is a need to define benefits that are non-commercial as a part of the determination of control.</li> </ul>
<p><i>Comments from respondents that neither agreed nor disagreed were as follows:</i></p>
<ul style="list-style-type: none"> <li>• The definition of control should be based on accountability.</li> <li>• Another respondent commented that there would need to be separate provisions on the reporting entity so that parent can determine whether the entities they have an interest in are controlled.</li> </ul>
<p><i>Comments from respondents that disagreed were as follows:</i></p>
<ul style="list-style-type: none"> <li>• NPOs had different reasons for different operating structures that are not akin to subsidiaries and NPOs are alone in having the obligation of donors of money resources and time.</li> <li>• In Australia the reporting entity definition does not follow the model in IFRS or IPSAS – an entity must determine if it is reasonable to expect users who will rely on the entity's general purpose financial statements to make decisions about the allocation of resources.</li> <li>• The definition of the reporting entity will be hampered without the associated consideration of consolidation.</li> </ul>



- The description does not adequately address fund raising entities such as NPOs established to undertake fundraising activities to support medical service provision including hospitals.

Table 2 Summary of Responses to Question SMC 1.d Preferred Alternative

*Respondents that preferred Alternative 1 - Using the Control Model under IFRS 10 included the following comments (note these comments may have been made by one or occasionally more than one respondent):*

- This was consistent with the key international frameworks and that this control framework was based on the substance of the transaction and not the form.
- Organisations can find it easier to understand the substance of the relationships in operation better than their legal forms. The control tests under alternative 1 can increase an understanding of the NPOs arrangements which can sometimes be informal and assist with improving the legal and financial reporting structures.
- Two respondents commented that the IASB and IPSASB frameworks do not use 'bright-lines' judgements that are not translatable to different country formats.

*Respondents that preferred Alternative 2 - Using the Control Model under IFRS form SMEs included the following comments (note these comments may have been made by one or occasionally more than one respondent):*

- Seven respondents indicated that Alternative 2 allows for a customised approach to NPOs based on pragmatic methods. The approach would be easier and more cost effective to apply without significant judgement (one respondent noted that this would make initial implementation easier).

*Respondents Not Wishing to Proceed with Either Alternative*

- Three respondents did not consider that either alternative was appropriate. Two respondents appear to hold similar views:
  - one noted that consolidation may be too complex or onerous for smaller NPOs and recommended that consideration be given to the reporting framework for Tier 3 in Australian financial reporting where consolidation is voluntary for not-for-profit entities for smaller NPOs with the alternative option of simple disclosure of significant relationships.
  - a second respondent appeared to recommend a similar solution but referred to this as a 'minimum entity accounting report'.



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- One respondent considered that the reporting entity should be recognised based on an NPO's output and mission.