

Financial reporting requirements for NSW Government entities including those affected by restructures

This circular explains the reporting entity concept, control principles and reporting requirements for NSW Public Sector entities and advises the effect of Government restructures on reporting. It applies to all departments, statutory bodies and the entities they control. This Circular withdraws and replaces the previous version (NSW TC 11/18).

Summary:

This Circular provides guidance to achieve consistency in preparing financial statements and annual reports for all entities including those affected by restructures.

All departments, statutory bodies and the entities they control must prepare separate financial statements. Therefore, whether an entity is listed in the *Public Finance and Audit Act 1983* (PFAA) Schedule 2 or 3 or the *State Owned Corporations Act 1989* (SOC Act) Schedule 5 is not the only criteria for preparing financial statements. In particular, a statutory body that is removed from PFAA Schedule 2 is still required to prepare financial statements because it is still an entity controlled by either a Minister or a department until it is dissolved by an Act of Parliament.

This Circular also explains that only entities listed in PFAA Schedule 2 or 3 or SOC Act Schedule 5 must prepare an annual report. In addition, a parent entity's annual report must include the financial statements of the parent, the economic entity and the separate financial statements of all controlled entities.

Any entity that is not listed in PFAA Schedules 2 or 3 or SOC Act Schedule 5, and is also not controlled by another entity should contact their Treasury Analyst to determine in which statutory body's or department's annual report its financial statements should be published.

This Circular withdraws and replaces NSW TC 11/18. The main changes from NSW TC 11/18 are:

- updated control principles and practical examples of control to reflect the new consolidation standard AASB 10 *Consolidated Financial Statements*, and
- replaced references to the *Public Sector Employment and Management Act 2002* (PSEMA), which has been repealed, with references to the *Government Sector Employment Act 2013* (GSEA).

In addition, the content and structure of the Circular has been simplified.

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1. Introduction

The objective of this Circular is to achieve consistency in the application of legislation and AAS for reporting by all NSW Public Sector entities. It explains the reporting entity concept and control principles, provides practical examples of control and details financial reporting, audit and annual reporting requirements for NSW Government controlled entities.

This Circular is issued for financial years beginning on or after 1 July 2014 and applies to all departments, statutory bodies and the entities they control.

2. Reporting Entities

2.1 Reporting Entity Concept

Statement of Accounting Concepts SAC 1 *Definition of the Reporting Entity* paragraph 40 states: “Reporting entities are all entities...in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports...”.

In addition, NSW legislation requires entities to prepare financial statements, as discussed below.

2.2 Statutory Bodies

The PFAA (sections 41A and 41B) requires all statutory bodies to prepare financial statements in accordance with AAS.

Statutory bodies are defined in the PFAA (section 39) as including:

- entities listed in PFAA Schedule 2, and
- entities over which a statutory body has control as defined in AAS.

In addition, the SOC Act (section 24A) makes:

- each statutory State Owned Corporation (statutory SOC) listed in SOC Act Schedule 5, and
 - each controlled entity of a statutory SOC
- a statutory body for PFAA financial reporting purposes.

Entities established under statute which are controlled by Ministers or departments that are neither:

- listed in PFAA Schedule 2 or in SOC Act Schedule 5, nor
 - controlled by another statutory body
- are captured by the PFAA definition of department (refer section 2.3 below).

2.3 Departments

Departments are administrative units of the Crown and are not separate legal entities. Departments and Ministers, however, control scarce resources and are accountable to users for those resources. This view is supported by AASB 101 *Presentation of Financial Statements*, which defines a government department as “a government controlled entity, created pursuant to administrative arrangements or otherwise designated as a government department by the government which controls it” (para Aus 7.2). According to AASB 101 “most, if not all, government departments are reporting entities” (para Aus 7.2).

The PFAA (sections 45D and 45E) requires all departments to prepare financial statements in accordance with AAS.

Departments are defined in the PFAA (section 45A) as including:

- entities listed in PFAA Schedule 3, and
- entities controlled by departments or controlled by Ministers.

As noted in section 2.2, entities established under statute which are controlled by Ministers or departments that are:

- not listed in PFAA Schedule 2 or SOC Act Schedule 5, and also
 - not controlled by another statutory body
- are captured by the PFAA definition of department (section 45A(1A)).

2.4 Control Principles

As noted above, entities over which a statutory body, a department or a Minister has control (as defined in AAS) are required to prepare financial statements.

AASB 10 *Consolidated Financial Statements* defines control and provides guidance on determining whether control exists over an entity. This replaces the control and consolidation guidance in AASB 127 *Consolidated and Separate Financial Statements*, and Interpretation 112 *Consolidation – special purpose entities*.

Control exists when an investor¹ “is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee²” (AASB 10 para. 6). That is, where the following 3 criteria are met (AASB 10 para. 7):

- power over the investee
- exposure, or rights, to variable returns from its involvement with the investee
- the ability to use its power over the investee to affect the amount of the investor’s returns.

The three limbs of the control definition are discussed in more detail below. Furthermore, common examples of control within the NSW public sector are outlined in section 3.

2.4.1 Power

Power over an investee arises when the investor has existing rights that give it the current ability to direct the relevant activities of the investee, regardless of whether the investor has exercised its rights i.e. substantive rights to direct the activities that *significantly* affect the investee’s returns (AASB 10 paras 10 and 12).

In the public sector, rights arising from administrative arrangements or statutory provisions will often be the source of power i.e. power established through the enabling legislation, specifying the investor’s rights to direct the operating and financing activities of an entity (investee). However the power to enact or change legislation does not give the investor the current ability to direct the relevant activities of the investee.

Determining whether a control relationship exists requires a detailed review of the facts and circumstances including identifying the entity’s purpose and its design, the relevant activities, and the rights of each party in directing the relevant activities³.

¹ “investor” refers to an entity that *potentially* controls one or more other entities (the investee).

² “investee” refers to an entity that is, or *potentially* may be, the controlled entity of another entity (the investor).

³ AASB 10 (Appendix B and E) provides further guidance in assessing the design, purpose and relevant activities of the investee, and the rights of each party.

An investor that holds only protective rights does not have power over an investee. Protective rights are designed to protect the interests of the investor, and generally relate to fundamental changes to the activities of an investee or apply in exceptional circumstances⁴ (AASB 10 para B26).

Indicators of power may include:

- voting rights - the ability to appoint or remove a majority of members of the governing body, Chief Executive Officer (CEO) or the body that directs the relevant activities
- government rights to approve or veto policy, operating and capital budgeting decisions in relation to the relevant activities. However rights held in order to *protect*, as distinct from *enhance*, the interests of the government or public are not indicators of power
- establishment of the constituting documents or enabling legislation of the entity. While being involved at inception is not sufficient alone to give control, it indicates the investor had the opportunity to obtain rights sufficient to give power; and
- economic dependence e.g. an entity may be dependent on a Minister or a government body, to fund a significant portion of its operations. However, in the absence of other rights, such dependence would not lead to the investor having power over the investee. For example, where acceptance of government resources or the manner in which they are deployed is at the discretion of the entity, even if government grants require compliance with specified conditions, there is no ability to direct the relevant activities of that entity.

2.4.2 Exposure or rights to variable returns

“An investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor’s returns ... have the potential to vary as a result of the investee’s performance” (AASB 10 para. 15). Returns are very broadly defined under the standard to encompass financial, non-financial, direct and indirect benefits, whether positive or negative, including achievement or furtherance of objectives.

2.4.3 Link between power and returns

The investor must have the ability to use its power to affect the investor’s returns from its involvement with the investee (AASB 10 para. 17). Therefore, the decision maker must determine whether it is a principal or an agent (AASB 10 para. 18)⁵. AASB 10 introduces the concept of delegated power, when an investor delegates its decision-making authority (power) to an agent on some specific issues or on all relevant activities.

2.4.3a Delegated power⁶

When assessing whether it controls an investee, the investor shall treat the decision-making rights delegated to its agent as held by the investor directly.

The determination of whether a decision-maker is an agent or principal requires consideration of the following:

- scope of its decision-making authority over the investee
- the rights held by other parties
- the remuneration to which it is entitled, and
- the decision-maker’s exposure to variability of returns from other interests it holds in the investee (AASB 10 para B60).

⁴ AASB 10 para B28 provides examples of protective rights.

⁵ An agent is a party primarily engaged to act on behalf and for the benefit of another party or parties (the “principal(s)”) and therefore does not control the investee when it exercises its decision-making authority.

⁶ For example, delegations by Minister to Department Head, trust fund entities under management.

An agent is a party primarily engaged to act on behalf and for the benefit of another party and therefore does not control the investee when it exercises the decision-making authority delegated to it. When reaching a conclusion, each of the factors is weighted according to the facts and circumstances of each case, which will require judgement. The only situation that is conclusive by itself is when removal rights are held by a single party and the decision-maker can be removed without cause.

Section 3.2 and 3.7 provides examples of delegated power.

2.4.4 Management judgement

The AASB 10 principles require significant judgment by management in determining whether entities are controlled and therefore consolidated. We encourage agencies to review AASB 10 and in particular the Not-for-Profit Implementation Guidance within the standard. Any agency with entity relationships which contain significant judgment or would be considered high risk, should liaise with Treasury in determining the appropriate accounting treatment.

2.4.5 Continuous assessment

As facts and circumstances indicate a change to one or more of the three elements of control, AASB 10 para. 8 requires control to be reassessed. Considerations include changes to the decision making rights of all parties, changes in exposure to variable returns, and changes to relationships which could mean no longer acting as an agent etc.

3. Controlled Entities of the Government

The following illustrates some common examples of controlled entities within the NSW Government:

3.1 A department controlled by a Minister

Departments are administrative units of the Government established by Administrative Arrangements Order. Department heads are responsible to a particular Minister for the performance of their department. Therefore, the Minister controls the department directly through the Department Head.

3.2 A statutory body controlled by a Minister

The enabling legislation of statutory bodies may give those statutory bodies' particular functions for which they are subject to the direction of a particular Minister. The same Minister may also be empowered to appoint and dismiss a majority of board members. In such cases, the Minister generally controls the statutory body directly by controlling the Board (i.e. not through a department).

These arrangements, however, depend on the enabling legislation, which can be amended. For example, legislation has been used to abolish the governing board of some entities and replace them with an 'Advisory Board' or 'Advisory Committee'. Replacing a governing board with an advisory board does not, of itself, change who controls the statutory body. If the relevant Minister can direct the CEO, then the Minister still controls the entity.

3.3 A statutory body controlled by a department

In some cases, in conjunction with the governing board being abolished (as noted at 3.2), the CEO of the statutory body is made accountable to the Department Head⁷. In such cases, where the statutory body is controlled by the department, the department must prepare consolidated financial statements, which consolidate the results of the statutory body. However, there must be consideration as to whether the department acts as an agent of the responsible Minister⁸ as this could lead to a different control conclusion.

If the department (or official of the department) acts as principal under a delegation of powers from the Minister and exercises its own discretion, not subject to specific direction by the Minister then the department would consolidate the statutory body into its consolidated financial statements (refer to 3.7).

If the department (or official of the department) acts as agent under the delegation of powers from the Minister, then the department would not consolidate the statutory body. Instead, the statutory body's financial statements will be directly consolidated into the Total State Sector accounts and the General Government Sector accounts (where relevant).

3.4 The same natural person may control two entities

The same natural person can be in control of more than one entity. This does not, of itself, mean that one entity controls the other. For example, the head of a department may also appoint the CEO of a statutory body. The department does not control the statutory body (or vice versa) where the Department Head reports to the relevant Minister in respect of that department and to the board of the statutory body or directly to the Minister in respect of that statutory body. Separate financial statements would be prepared for that department and that statutory body.

3.5 Statutory bodies without staff

In some cases, statutory bodies have no staff of their own. The functions of the statutory body are performed on behalf of the statutory body by staff of another entity, usually a department, effectively by a service agreement. The existence of a service agreement between any two entities does not, of itself, mean that one entity controls the other (however see 3.6 below).

3.6 Statutory bodies controlling other Public Service agencies

GSEA Schedule 1 lists various agencies of the Crown assigned to statutory corporations. These agencies are separate reporting entities required to prepare their own financial statements. Where such an agency's only function is to provide staff for a particular statutory body, the staff agency is controlled by that particular statutory body. In this case, the parent statutory body must prepare financial statements, which consolidate the staff agency.

3.7 Delegations by a Minister to a Department Head regarding a statutory body

AASB 10 contemplates situations where a department or a Minister controls a statutory body. Considerations will include:

- detailed review of the rights under the enabling legislation to determine which party holds substantive rights (rather than protective rights)
- whether the delegated powers give the department the current ability to direct the relevant activities i.e. are they acting as principal in exercising their own discretion without being subject to specific direction by the Minister?
- who can appoint the governing council (Minister or Department Head)?
- who can approve the major decisions (Minister or Department Head)?

⁷ In most cases the Department Head is the Secretary of the department.

⁸ That is, merely authorised by the Minister to act on the Minister's behalf.

If the scope of decision-making authority held by the Department Head is significant as a result of the delegations by the Minister to the Department Head⁹, and the Department Head has the ability to use this power to affect the nature and amount of the department's returns from its involvement with the statutory body, the department acts as principal under the delegations and controls the statutory body.

The department would then consolidate the statutory body into its consolidated financial statements.

3.8 Trust Fund entities under management, controlled by the trustee

There may be situations when funds under management (held in a separate trust entity) may be controlled by the trustee. Considerations will include:

- does the trustee set the investment policy and have broad discretion on how the funds are invested?
- does the trustee have significant exposure to variable returns i.e. are the earnings from investment of the monies held for the benefit of the clients or retained by the trustee? May the earnings be used to fund a variety of public purposes, including meeting government expenditure? Is there exposure to capital gains and losses or variations in interest or other investment returns?
- does the trustee have the ability to use its power to further its own objectives?
- does the trustee have the ability to access future economic benefits through the direction of monies in the accounts, including the application of those amounts to its running costs and other policy objectives?

If the trust fund entity was determined as controlled, it would be consolidated by the trustee agency.

4. Financial Reporting Requirements

4.1 Financial reporting by entities

PFAA requires all departments, statutory bodies and controlled entities of these bodies to prepare financial statements in accordance with AAS even if no financial statements would be required under other legislation (where applicable), for example:

- A *Corporations Act 2001* "small proprietary company" or "small company limited by guarantee" does not have to prepare financial statements under that Act unless directed to do so by shareholders or members with at least 5% of the votes or the Australian Securities and Investments Commission (ASIC)¹⁰.
- Under *ASIC Class Order 98/1418*, certain wholly-owned subsidiaries may be relieved from the requirement to prepare and lodge financial statements under the *Corporations Act 2001* where they have entered into cross guarantees with their parent in certain circumstances.

For further information on 'statutory bodies' and 'departments' refer to sections 2.2 and 2.3.

⁹ Such that the department has the current ability to direct the relevant activities of a statutory body so as to achieve the objectives of the department.

¹⁰ Section 292 of the *Corporations Act 2001*.

4.2 Financial reporting by consolidated entities

AASB 10 requires parent entities to prepare consolidated financial statements presenting the results of the parent and its controlled entities as a single economic entity. The requirement to prepare consolidated financial statements is in addition to the separate financial statements of the parent entity and the separate financial statements of its controlled entities.

The parent entity's financial statements are reported as additional columns within the consolidated financial statements. AASB 127 *Separate Financial Statements* prescribes the accounting and disclosure requirements relevant to the parent entity financial statements.

4.3 Additional financial reporting requirements for some entities

In addition to the PFAA, some NSW public sector entities are required to prepare financial statements under other legislative requirements, for example, under the *Corporations Act 2001*. The financial statements of these entities should address the additional reporting requirements of those Acts.

5. Audit

The Auditor-General is required to audit the financial statements of all statutory bodies and departments (PFAA sections 41C and 45F) that are required to prepare financial statements under the PFAA; i.e. irrespective of whether they are listed in PFAA Schedule 2 or 3 or SOC Act Schedule 5 or are controlled by Ministers, other departments or statutory bodies.

To facilitate this, PFAA section 63B requires departments and statutory bodies to notify the Treasurer and Auditor-General within one month of the acquisition or formation of a controlled entity.

The Auditor-General can also audit the financial statements of entities other than departments and statutory bodies at the request of a Minister or the Treasurer (PFAA section 45).

6. Annual Reporting

6.1 Entities listed in PFAA or SOC Act

The *Annual Reports (Statutory Bodies) Act 1984* (ARSBA) and the *Annual Reports (Departments) Act 1985* (ARDA) requires all statutory bodies and departments listed in PFAA Schedule 2 and Schedule 3 to produce annual reports. In addition, due to the SOC Act section 24A, SOCs listed in SOC Act Schedule 5 meet the ARSBA definition of "statutory body". As a result, each statutory SOC must prepare an annual report in accordance with ARSBA and its associated regulation.

ARSBA and ARDA and the associated regulations set out mandatory annual reporting disclosure requirements for statutory bodies and departments listed in PFAA Schedule 2 and Schedule 3, and SOC Act Schedule 5.

The annual report of an entity listed in PFAA or SOC Act is prepared for the parent entity (i.e. not the consolidated group). However, the annual report of a parent entity must include the separate audited financial statements of its controlled entities (ARSBA section 7 and ARDA section 9) and a detailed statement of the name, objectives, operating activities, performance targets and actual performance measures for each controlled entity.

For further information on annual reporting, refer to the Annual Reporting page on Treasury's website¹¹.

¹¹ http://www.treasury.nsw.gov.au/Annual_Reporting/Annual_Reporting

6.2 Entities not listed in PFAA or SOC Act

Entities which are not listed in PFAA Schedules 2 or 3 or SOC Act Schedule 5 (including special purpose staff agencies) are not required to produce separate annual reports. However, as discussed above, the ARDA and ARSBA requires the annual report of parent entities to include the financial statements of their controlled entities.

Any entity that is not listed in PFAA Schedules 2 or 3 or SOC Act Schedule 5, and is also not controlled by another entity should contact their Treasury Analyst to determine in which statutory body's or department's annual report its financial statements should be published.

6.3 Additional reporting requirements

NSWTC 11/19 *Financial and Annual Reporting requirements arising from personnel service arrangements* (or any replacement circular) requires statutory bodies that control a special purpose staff agency to disclose additional employment related information in their annual report.

7. Restructures

Restructures (including amalgamations) of Government are generally affected by an Administrative Arrangements Order or by amendments to Acts of Parliament.

Administrative Arrangement Orders can abolish departments because departments are only administrative arrangements of the Government. A department's obligation to prepare separate financial statements generally ceases when it has been abolished by an Administrative Arrangements Order.

Administrative Arrangements Orders, however, cannot abolish statutory bodies. Statutory bodies are usually established as separate legal entities by Act of Parliament and therefore must continue to report until dissolved by Act of Parliament. Therefore, removing a statutory body's name from PFAA Schedule 2 does not remove the requirement on that statutory body to prepare separate financial statements. Such a statutory body remains a separate entity controlled by a Minister or a department and is therefore required to report separately under PFAA section 45A(1A) until it is dissolved.

'Cluster groups' created by restructures are not separate reporting entities and are not required to prepare separate financial statements or annual reports unless there is a control relationship between entities within the cluster. In those cases (and as previously explained), the parent entity is required to prepare consolidated financial statements.

As outlined in section 4 and 6, financial statements and annual reports are required for the individual departments and statutory bodies within each cluster.

8. Withdrawal and Replacement of NSW TC 11/18

This Circular withdraws and replaces NSW TC 11/18 *Financial reporting requirements for NSW Government entities including those affected by restructures*. The main changes from NSW TC 11/18 are:

- updated control principles and practical examples of control to reflect the new consolidation standard AASB 10 *Consolidated Financial Statements*, and
- replaced references to the PSEMA, which has been repealed, with references to GSEA.