Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Not-for-Profit (NFP) Entity Definition and Guidance**	**Meeting:**	AASB April 2020 (M175)
Topic:	**Further staff analysis and recommendations on certain responses to ED 291**	**Agenda Item:**	7.1
		Date	14 April 2020
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		Decision-Making:	High
		Project Status:	Consider specific comments on ED and determine next steps

OBJECTIVE OF THIS PAPER

1 The objective of this agenda item is for the Board to:

(a) **agree** to amend the implementation guidance tentatively agreed at its March meeting to "the entity maximising financial benefits to equity holders" and **agree** to include in the implementation guidance non-exhaustive instances when the presumption that the entity is a not-for-profit (NFP) for financial reporting if it is NFP for taxation purposes" is rebutted;

(b) **decide** how to address feedback provided by constituents on Exposure Draft 291 *Not-for-Profit Definition and* Guidance (ED 291) in respect of the terms used in the proposed definition and implementation guidance: "equity", "equity holder", "primary objectives", "community or social benefit", "goods and services" and "financial benefits"; and

(c) **agree** to refine the structure and content of implementation guidance and illustrative examples to incorporate proposals in paragraph 1(a) above and in response to the feedback provided by constituents on ED 291.

REASONS FOR THE BOARD TO CONSIDER THIS PAPER AT THIS MEETING

2 The Board made the tentative decision at its March 2020 meeting in response to the key issue of the interaction of the proposed NFP entity definition in Exposure Draft 291 *Not-for-Profit Definition and* Guidance (ED 291) with other existing definitions (such as ACNC, ATO and GFS manual), to amend implementation guidance proposed in the ED 291 adding clarification that "an entity is an NFP for financial reporting if it is NFP for taxation purposes, unless its primary purpose is for the financial benefit of its equity holders".

3 When incorporating the clarification in par. 2 above into the implementation guidance, staff re-considered whether rebuttal of the presumption "an entity is an NFP for financial reporting if it

is NFP for taxation purposes" with alternative references to "equity is provided to maximise the financial benefit to equity holders" and "entity maximising the financial benefits to equity holders" would provide a simpler assessment pathway, compared to assessing whether entity's primary purpose is for the financial benefit of its equity holder(s). Staff also considered instances when the presumption would be rebutted. For analysis and recommendations, see paragraphs 9-15.

4 At the March meeting the Board also instructed staff to further clarify the key terms, including "primary purpose", "financial benefit" and "equity holders" to reduce ambiguity and improve the usefulness of the existing implementation guidance which also has been raised by the respondents to the ED 291. In addition to matters in paragraphs 2 - 3 above, this paper also considers following issues identified in the Staff Paper 3.1 for the November AASB meeting:

- Issue 2-SMC1: *Suitability of "equity" concept for some NFP entities*
- Issue 4-SMC1: *Further clarification/guidance needed for key indicators, including 'primary objective', 'community or social benefit', 'goods and services' and 'equity holder'*
- Issue 7-SMC2: *Weighting of multiple indicators in determining the classification*
- Issue 14-SMC7: *Inconclusive implementation guidance*

5 Subject to the Board decisions at its April meeting, staff will subsequently perform further analysis and make recommendations for the remaining issues below and bring them to future Board meeting(s):

- Issue 8-SMC2: *Suitability of implementation guidance and illustrative example for the public sector entities*
- Issue 9-SMC3: *Impact of classification of controlling entity on the classification of the group*
- Issue 10-SMC4: *Effective date of the proposals to be aligned with NFP reporting framework and interaction with proposals in ED 297*
- Issue 11-SMC4: *More guidance on differences in Australian accounting standards requirements for FP and NFP*
- Issue 12-SMC4: *Disclosure of the reasons for the classification as NFP/FP in the basis of preparation*
- Issue 13-SMC5: *Transitional relief*

ATTACHMENTS

6 Staff have included the following attachments for the Board's reference:

7.2 Agenda Paper 3.1 (M173) *Staff paper: Initial summary responses to ED 291* [included in the supplementary folder]

SUMMARY OF STAFF RECOMMENDATIONS

7 Based on the analysis further below, staff make the following recommendations to the Board to:

(a) amend the rebuttable presumption for entities that are NFP for tax to "an entity is NFP for financial reporting if it is NFP for taxation purposes, unless the entity maximises the financial benefits to equity holders" and provide instances in the implementation guidance when the presumption is rebutted (par. 9 - 15) [1]:

(i) an entity without clearly defined equity instruments (e.g. companies limited by guarantee, trusts, co-operatives etc.) maximising and distributing financial returns to equity holders (either directly or indirectly through related parties) via donations, rebates, discounted services or in another form;

(ii) a subsidiary set-up with the aim to maximise returns to its NFP parent and/or related parties. The subsidiary is for-profit (FP) in nature on a stand-alone basis while its parent and/or group may be NFP;

(iii) an entity with clear objective to maximise financial returns to equity holders irrespective whether the financial benefits are in fact distributed and irrespective of the form of the distribution.

(b) clarify that, for purposes of the assessment of NFP classification for financial reporting, "equity" is the residual interest in the assets of the entity after deduction of its liabilities, based on the definition in *Conceptual Framework for Financial Reporting* (RCF) and *Framework for the Preparation and Presentation of Financial Statements* (CF 2014) and to amend par. 29 of the implementation guidance as follows (added text underlined):

"29 For the purpose of assessing the classification of an entity for financial reporting:

(a) equity is the residual interest in the assets of the entity after deduction of its liabilities as defined in paragraph 4.63 of the *Conceptual Framework for Financial Reporting* and paragraph 49 (c) of the *Framework for the Preparation and Presentation of Financial Statements*;

(b) equity holders are the holders of any equity claims of an entity and in absence of clear equity instruments, equity holders are those who have the rights to direct the use of the economic resources of the entity.

Where an entity is established…."

(c) clarify that NFP entities include those operate for community and social benefit (i.e. do not necessarily provide goods and services) and amend par. 21 of the Implementation Guidance:

"21 …Instead, they exist to provide goods or services for community or social benefit (in other word, they operate for community or social benefit). Hence… "

(d) add two flowcharts to the implementation guidance to assist entities with the NFP assessment for the financial reporting purpose;

(e) agree for staff to restructure the existing illustrative examples as proposed in Appendix A and agree to provide conclusive assessments for these examples.

[1] See *Appendix B: Relevant Cases* of *Staff paper 13.1 Not-for-Profit Entity Definition and Guidance* (M174) for summary of relevant court cases.

STRUCTURE

8 This Staff Paper is set out as follows:

(a) Staff analysis (par. 9 - 16)

(b) Next steps (par. 17)

(c) Appendix A: Draft of proposed re-structured Illustrative Example

STAFF ANALYSIS AND RECOMMENDATIONS

9 The clarification the Board approved at March meeting referred in par. 2 aims to simplify the assessment process for entities self-assessed as NFP for taxation purpose so that these entities do not need to go through the full implementation guidance to assess their classification for financial reporting purpose. Based on the ATO requirements summarised in par. 17 of the March 2020 Staff Paper 13.1, such entities would have:

(a) a primary purpose to provide community and social benefits and not carried on for the profit or gain of its individual members, which satisfy the first limb of the proposed definition in ED 291; and

(b) constitution document contains a non-distribution clause prohibiting distribution of net income to its equity holders, both during operation and winding up.

10 However, entities can distribute financial benefits to the equity holders in a number of ways despite the existence of a non-distribution clause, for example through donations, provision of discounted services and provision of rebates. These entities therefore will still need to assess whether the entity operates to maximise the financial benefits, directly and indirectly (e.g. including other means other than distribution of surplus or profits), to equity holders.

11 Staff considered whether providing examples of circumstances rebutting the presumption "an entity is an NFP for financial reporting if it is NFP for taxation purpose" in the implementation guidance would be helpful for the entities in their assessment. Staff considered the following scenarios:

(a) an entity without clearly defined equity instruments (e.g. companies limited by guarantee, trusts, co-operatives etc.) maximising and distributing financial returns to equity holders (either directly or indirectly through related parties) via donations, rebates, discounted services or in another form;

(b) a subsidiary set-up with the aim to maximise returns to its NFP parent and/or related parties. The subsidiary is FP in nature on a stand-alone basis while its parent and/or group may be NFP;

(c) an entity with clear objective to maximise financial returns to equity holders irrespective whether the financial benefits are in fact distributed and irrespective of the form of the distribution.

12 When considering scenarios in par. 11, staff have reconsidered whether the criterion of the rebuttal being entity's primary purpose for the financial benefit of its equity holders (assessed in isolation and without assessing other indicators) is achieving the most efficient assessment process for the entities self-assessed as NFP for taxation purpose which is primary aim of the

rebuttable presumption. On this basis, staff have considered following alternative criteria to rebut the presumption:

(a) entity with equity provided to maximise financial benefits to the equity holders; and

(b) entity maximising the financial benefits for the equity holders.

13 All three criteria, i.e. the criterion of primary purpose for financial benefit considered at March meeting and the two alternative criteria provided in paragraph 12 above would require judgement. Staff considered following factors:

(a) The criteria linked to the primary purpose and purpose of the equity would effectively require entity to assess indicators provided in the implementation guidance which could conflict with the aim to simplify the assessment.

(b) In addition, the primary purpose for the financial benefit of the equity holder could raise question whether the test is about the primary objective (first limb of the proposed definition) or existence of the financial returns on the equity provided (second limb of the proposed definition).

(c) Also, in many instances it may not be straight forward for the entities to distinguish between primary and other objectives and entities without clear equity instruments may find the rebuttal considered in par. 12(a) unclear and hard to implement.

(d) The above complexities could lead to unnecessary effort and cost associated with the assessment in contrary with the aim of the clarification to simplify the process.

(e) Staff have considered criterion in par. 12(b) with aim to provide factual guidance without necessity to assess the indicators and rest of the implementation guidance. Staff considers that limited judgment would be required to determine whether entity maximises financial benefits to equity holders and providing examples of the scenarios (par. 11) would mitigate this further.

14 Staff believes that the criterion listed in par. 12 (b) along with the examples of rebuttal instances considered in par. 11 would provide a simpler pathway for assessment without need to consider indicators in the implementation guidance. Staff therefore propose to amend the clarification to “an entity is an NFP for financial reporting if it is NFP for taxation purposes, unless the entity maximises the financial benefit to equity holders” and list) the examples of instances (non-exhaustive) when the presumption would be rebutted.

15 Other entities, including private sector entities that are not assessed as NFP for tax purposes and public sector entities, will still need to determine their classification based on the assessment using the implementation guidance (see discussion of Issue 7 - SMC 2 and Issue 14 - SMC 7 further below).

Question 1 to the Boad:

Does the Board agree with staff recommendation to amend the clarification for entities self-assessed as NFP for taxation purposes to:

> **“an entity is an NFP for financial reporting if it is NFP for taxation purposes, unless it maximises financial benefits to equity holders”?**

If not, does the Board prefer the clarification as approved at March meeting?

If not, does the Board prefer amendment clarifications as considered in par. 12(a):

> **"an entity is an NFP for financial reporting if it is a NFP for taxation purposes, unless the entity's equity is provided to maximise financial benefits to the equity holders"?**

Question 2 to the Board:

Does the Board agree to include in the implementation guidance the following non-exhaustive instances when an entity is not a NFP entity for financial reporting despite its NFP self-assessment for taxation purposes:

(a) an entity without clearly defined equity instruments (e.g. companies limited by guarantee, trusts, co-operatives etc.) maximising and distributing financial returns to equity holders (either directly or indirectly through related parties) via donations, rebates, discounted services or in another form;

(b) a subsidiary set-up with the aim to maximise returns to its NFP parent and/or related parties. The subsidiary is FP in nature on a stand-alone basis while its parent and/or group may be NFP;

(c) an entity with clear objective to maximise financial returns to equity holders irrespective whether the financial benefits are in fact distributed and irrespective of the form of the distribution.

16 Staff have analysed the following issues raised by respondents to ED 291 and would like to seek for feedback from the Board at its April 2020 meeting.

Issue 2–SMC1: ***Suitability of "equity" concept for some NFP entities***

Six respondents (S8-ACAG, S12-HoTARAC, S13-Deloitte, S14-BCCM, S15-LCA, S16-QLS) are concerned with the use of the term of 'equity' in the proposed definition that is not suitable for all NFP entities given the wide variety of structures that feature in this sector.

For example, S13-Deloitte pointed out that "…*in cases of subscription-based or membership-based entities, the members or subscribers are the parties who provide the necessary funds for the operations or the entity via the fees it pays and are the parties who essentially obtain the benefits through the operations of the entity, but in essence, they are not considered to be equity holders as they do not contribute 'equity'*." S14-BCCM urged AASB to consider implications of the proposed definition for NFP mutual entities that elect to issue Mutual Capital instruments and may make distributions on these instruments.

Similarly, S12-HoTARAC suggested to replace the term 'equity' and 'equity holders' with 'owners' contribution' and 'owners' respectively, or to add equity and equity holders to the list of defined terms and explicitly define this to include a broad range of arrangements. Minority of S12-HoTARAC also disagreed with the return of the surplus to owners being key leg of the definition as these criterion does not suit well for the public sector.

Staff Analysis

Staff consider terms "equity" and "equity holders" appropriate for the purposes of NFP assessment for financial reporting subject to the further clarification proposed below.

Equity

Staff consider that definition of "contribution by owners" may be more restrictive than the definition of "equity" in the Conceptual Framework. "Equity" is defined as the "*residual interest in the assets of the entity after deduction of its liabilities*" (RCF, par. 4.63; CF 2014, par. 49(c)). AASB 1004 *Contributions* and AASB 1058 *Income of Not-for-Profit Entities* define "contributions by owners" as follows:

> *"Future economic benefits that have been contributed to the entity by parties external to the entity, other than those which result in liabilities of the entity, that give rise to a financial interest in the net assets of the entity which:*
>
> *(a) conveys entitlement both to distributions of future economic benefits by the entity during its life, such distributions being at the discretion of the ownership group or its representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or*
>
> *(b) can be sold, transferred or redeemed."*

The above definition focuses on the future economic benefit **contributed** to the entities and does not include other forms of residual interest, such as returned earnings and other equity reserves and implies that the distributions should be to the owners/equity holders.

Many NFP entities have clauses preventing distributions to the ownership group and/or have equity instruments that cannot be sold transferred or redeemed (e.g. companies limited by guarantee), which may be considered not to meet the definition of "contributions by owners" above. However the current Conceptual Framework definition of equity applied to these entities would likely result in them having control of any residual interest if holders of the entitlement or other parties (such as members) has the right to direct the use of the residual interest (e.g. retained earnings) or right to direct the use of the economic resources, effectively making them “equity holders”. Therefore, “equity” as prescribed by “contribution by owners” definition above may be considered more restrictive than how “equity” is defined in the Conceptual Framework.

Also, the term “contribution by owners” (defined in AASB 1004 and AASB 1058*)* is only applicable NFP entities, which may not fit the purposes of NFP (and therefore FP) assessment for financial reporting purposes. In contrast, the definition of “equity” in Conceptual Framework applies to all reporting entities, regardless of the entities’ legal and regulatory frameworks as par. 4.67 of the RCF states that “*Business activities are often undertaken by entities such as sole proprietorships, partnerships, trusts or various types of government business undertakings. The legal and regulatory frameworks … are often different …. For example, there may be few, if any restrictions on the distribution to holders of equity claims against the entities. Nevertheless, the definition of equity in paragraph 4.63 of the* Conceptual Framework [RCF] *applies to all reporting entities.*”

Some may interpret “equity” in the proposed definition as “contributed equity/capital” rather than how equity is defined in the Conceptual Framework. Admittedly, some entities may not necessarily have any clear contributed equity, such as some trusts, companies limited by guarantee or incorporated associations, but they may have “equity” from retained earnings or other reserves (e.g. asset revaluation reserve) and similar would apply to public sector entities.

Concerns for the inconsistency of definition of “equity” in Conceptual Framework and “owner’s contribution” in AASB 1004 and AASB 1058 were also raised in earlier projects, for example during the development of AASB Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities* and ED 260 *Income of Not-for-Profit Entities* (the precursor to AASB 1058*).* As noted in AASB 1058 (BC 167 and 173), to expedite proposals contained in ED 260, the Board decided to retain the term “contributions by owners” as currently defined and to address the issue as part of the NFP conceptual framework project.

Equity holders

Staff also consider “owners” to be a more restrictive concept than “equity holders”. “Owner” is defined as the “holders of instruments classified as equity” in AASB 101 *Presentation of Financial Statements*. When entities do not have any clear identified equity instruments, such as trusts and subscription-/membership-based entities, the concept of “owner” may not be applicable, while there still may be existing rights to the residual assets or rights to direct use of the economic resources of the entity.

“Equity holders” is not explicitly defined in AAS. Staff considers term “equity holder” would commonly mean to be the holders of equity claims based on par. 4.65 of the RCF. “Equity claims” refers to “claims against the entity that do not meet the definition of a liability” (RCF, par. 4.64). For the purposes of the NFP assessment for financial reporting, staff considered to include in the definition of equity holders also parties who have existing rights to direct the use of economic resources in absence of clearly defined equity instruments and in absence of clear rights to the residual assets.

In analogy to Conceptual Framework, staff argue that “equity holders” could also include those who have “control” of the entities' economic residual resources, which give them “the present ability to direct the use of the economic resources and obtain the economic benefit that may flow from it[2] (RCF, par. 4.20)” and “…if the resource produces economic benefits, the [control] entity is the party that will obtain them either directly or indirectly (RCF, par. 4.23). Applying this

[2] Par 4.20 of RCF states that “an entity controls an economic resource if it has the present ability to direct the use of the economic resource and obtain the economic benefits that may flow from it. Control includes the present ability to prevent other parties from directing the use of the economic resource and from obtaining the economic benefits that may flow from it.”

argument to the public sector, the department/agency which is entitled to receive the surplus or direct the use of the economic resources of a given entity is the equity holder of this entity.

"Equity holder" may exercise control directly to determine the use of the economic resources or indirectly via the (management) committee that direct the use of the economic resources (if they control the composition of the committee through their collective voting rights). This is normally realized through the agent-principal relationship. Par 4.25 of the RCF explain the agent-principal relationship as "*sometimes one party (a principal) engages another party (an agent) to act on behalf, and for the benefit of, the principal…If an agent has custody of an economic resource controlled by principal, that economic resource is not an asset of the agent. Furthermore, if the agent has an obligation to transfer to a third party an economic resource controlled by the principal, that obligation is not a liability of the agent, because the economic resource that would be transferred is the principal's economic resources, not the agent's*".

For example, in a trust, trustee (the agent) manages the trust fund on behalf of the beneficiaries (the principals). The trustee has a custody of the resources and determines the use of these resources on behalf of the beneficiaries. Beneficiaries, though may not be directly involved in decision-making of the day-to-day operation, however still may control the economic resources as they control economic benefit that flows from the resources.

Similarly, in membership-based entities, as S13 - Deloitte pointed out, the members are the parties who provide the necessary funds for the operations or the entity via the fees it pays. Members may be not considered to be equity holders when the restrictive view of "equity" is taken. However, in analogy to the Conceptual Framework, members could be considered as the equity holders of the entities with the right and (collective) ability to direct use of economic resources. The management of the membership-based entity have custody of the assets on behalf of the members, but the economic resource is not an asset of the management. This would also apply to the holders of mutual capital instruments.

Staff are aware of the principle of *control* defined in AASB 10 *Consolidated Financial Statements*. In accordance with AASB 10, application of control to identify whether an investor controls an investee serve as the basis to determine whether the investor need to consolidate the investee. Equity holders may not necessarily control the investee, e.g. being as a minority shareholder, as defined in AASB 10, but they would still satisfy (in analogy) concept of control in the Conceptual Framework, considering they 1) have the present (collective) ability to direct the use of economic resources via voting or nominating the agent to manage the assets/liabilities and/or 2) entitled to the economic benefits flow from their portion of the economic resources.

The staff noted that some issues identified through the research fundamental to the notion of control, such as *control of asset* (AASB 2013-8 *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Entities – Control and Structure Entities,* par. BC4). Therefore, staff consider that reference to the "right to direct the use of the economic resources" as an extension of the term "equity holders" for the purposes of NFP assessment for financial reporting is preferable as removes confusion with control concept as defined in AASB 10.

Based on the analysis above, staff consider "equity holder" to be broader and would better accommodate different legal and regulatory framework of various types of entities for the purpose of the assessment of classification for financial reporting. However, for the purposes of the NFP assessment for financial reporting, staff propose to further clarify the definition of the terms.

Staff recommendation

Based on the analysis above, staff recommend retaining the terms of 'equity' and 'equity holder' in the proposed new definition and to include the following clarification in section 'Nature of equity interest', par. 29 (added text underlined):

"29 For the purpose of assessing the classification of an entity for financial reporting:

(a) equity is the residual interest in the assets of the entity after deduction of its liability as defined in paragraph 4.63 of the *Conceptual Framework for Financial Reporting* and paragraph 49 (c) of the *Framework for the Preparation and Presentation of Financial Statements*;

(b) equity holders are the holders of any equity claims of an entity and in absence of clear equity instruments, equity holders are those who have the rights to direct the use of the economic resources of the entity.

Where an entity is established…."

Question 3 to the Board:

Does the Board agree with the staff recommendation to amend paragraph 29 of the implementation guidance in the ED?

(a) If not, does the Board prefer to use "contributions by owners" and if so, why?
(b) If not, what alternative options does the Board suggest?

Issue 4–SMC1: *Further clarification/guidance needed for key indicators, including 'primary objective', 'community or social benefit', 'goods and services', 'equity holder'* and *'financial benefit'*

One respondent (S3-KPMG) was concerned about the potential difficulties in determining whether the community or social benefit criterion would be met by an entity's objective, as the assessment could be highly subjective. The respondent recommended additional guidance to minimise the potential diversity that could arise from exercising the significant judgement required for this assessment. Three other respondents (S8-ACAG; S9-SD, S15-LCA) also requested further clarification of the term 'community or social benefit' used in the proposed definition, or to provide clear illustrative example for the term. S15-LCA also requested clarification of terms 'primary objective', 'goods & services' and 'equity holder' and expressed the concerns that the proposed definition is not unclear as to "*whether it only applies to entities which provide goods or services, or whether it can be read to apply to entities which provide social benefit… For example, a grant-making foundation does not provide 'goods or services' according to the ordinary meaning of those terms. Similarly, religious organisations may not provide goods and services."* S7-ACNC recommended amendments to the guidance referring to the 'nature of equity interest' and 'purpose and use of assets' to clarify that ACNC registered charity generating a financial benefit solely for other registered charities or philanthropic trusts holding assets mainly for sale or to generate profit in order to make grants to other NFP organisations are NFP entities themselves.

At its March meeting, the Board also instructed staff to further clarify the key terms, including "primary purposes", "financial benefit" and "equity holders" to reduce ambiguity and improve the usefulness of the existing implementation guidance which also has been raised by the respondents to the ED 291.

Terms used	**Staff analysis**	**Staff Recommendation**
"Primary Objectives" and *"Community or Social Benefit"*	The Board acknowledged in the ED 291 (Appendix B, par.10) that professional judgement is required in classifying an entity as FP or NFP.	Staff do not recommend any further clarification for these two terms.

	In the implementation guidance of ED 291 (Appendix B, par.17, the Board has suggested that *"in assessing the substance of the purpose of the entity where there are multiple objectives, it may be helpful to consider how the entity assesses its performance, as this may indicate which of its stated objective is its primary objective. For example, if the performance targets focus on the level/amount of benefits that have been delivered to achieve a community or social outcome, rather than rate of return on assets, then the entity would more likely to be an NFP entity. They entity could then use their established social and community-focused performance measures as the basis to determining whether the community or social benefit criterion is met or not."* With consideration of the amendment approved at March Board meeting and in the light of the discussion and proposals in this staff paper aimed at simplification of the assessment, staff do not consider further guidance needed to determine "primary objective" and "community or social benefit" acknowledging some degree of judgement will always be required.	
"*Goods and Services*"	Staff consider that providing "goods and services" is not limited to only the activities that generate financial surplus to service provider. One of the common meaning of service is "action of helping or doing work for someone". The Board acknowledges that activities NFP entities engaged in are within the scope of providing "goods and services" that "*NFP entities… exist to provide goods or services for community or social benefit. Hence, if an entity provides goods or services to recipients at no cost or for nominal consideration, the entity is likely to be a NFP entity*" (ED 291 Implementation Guidance, par. 21). Staff consider that if an entity's primary objective is to raise funds or makes grant, this entity is providing 'service' through those activities for its targeted service recipients. Staff acknowledge the comments from S15-LCA that organisations/entities such as religious organisations, may not necessarily provide goods and services, but they are operating for community and social benefit. Therefore, staff recommend amending the implementation guidance to clarify that NFP entities include those operate for community or social benefit.	Staff recommend amending par. 21 of the Implementation Guidance in ED 291 to: 21 …Instead, they exist to provide goods or services for community or social benefit <u>(in other words, they operate for community or social benefit)</u>. Hence…
"*Equity holders*"	Please refer to the analysis and recommendation for Issue 2–SMC1 Suitability of "equity" concept for some NFP entities above.	

"*Financial benefits*"	"Financial benefit" is not a defined term and could be assessed in various ways as the Board acknowledged in the ED 291 (Appendix B, paragraph 24) "*When considering the quantum of the expected financial benefits and the nature of the benefits provided by an entity, it is important to recognise that the generation of profits and payment of dividends is only one form of financial benefit that can be provided to equity holders. There are many other forms of financial benefit that can be returned to members or equity holders. For example, co-operatives may provide a financial benefit to members by paying a rebate based on the volume of transactions with the entity rather than through the payment of dividends. Another example of a financial benefit is the provision of discounted goods and services by an entity to its members."* Professional judgement is required to assess whether an entity is providing financial benefits, whether to equity holders or other beneficiaries. To ascertain need to provide further guidance for the purposes of NFP assessment for financial reporting, staff considered examples of financial benefit provided in *Corporation Act 2001*, section 229 (noting the context of related party assessment), such as: (a) giving or providing the related party finance or property; (b) buying an asset from or selling an asset to the related party; (c) leasing an asset from or to the related party; (d) supplying services to or receiving services from the related party; (e) issuing securities or granting an option to the related party; (f) taking up or releasing an obligation of the related party. Staff also noted that the section 229 considers giving a financial benefit includes: (a) Giving a financial benefit indirectly, for example, through 1 or more interposed entities; (b) Giving a financial benefit by making an informal agreement, oral agreement or an agreement that has no binding force; (c) Giving a financial benefit that does not involve paying money (for example by conferring a financial advantage)."	Staff do not recommend any further clarification on the term "financial benefits". Staff have proposed further guidance is needed to provide when the presumption that NFP tax status is also NFP financial reporting status would be rebutted (par. 9-15) and recommended developing additional illustrative examples for the instances staff considered in par. 11 when entity is not an NFP entity for financial reporting despite its NFP self-assessment for taxation purposes: (a) an entity without clearly defined equity instrument (e.g. companies limited by guarantee, trusts, co-operatives etc.) maximising and distributing financial returns to equity holders (either directly or indirectly through related parties) via donations, rebates, discounted services or in another form; (b) a subsidiary set-up with the aim to maximise returns to its NFP parent and/or related parties. The subsidiary is FP in nature on a stand-alone basis while its parent and/or group may be NFP; (c) an entity with clear objective to maximise financial returns to equity holders irrespective whether the financial benefits are in fact distributed and irrespective of the form of the distribution.

	Comparing the examples in the Corporations Act to the examples provided in the ED 291 implementation guidance, staff do not believe that there is need to provide further guidance on this term.	

Question 4 to the Board:

Does the Board agree with staff recommendations in the table above?

Issue 7–SMC2: ***Weighting of multiple indicators in determining the classification***

Issue 14–SMC7: ***Inconclusive implementation guidance***

S8-ACAG requested guidance to demonstrate how to apply the weighting of the indicators referred to in paragraph 37 of the ED and suggested some indicators (e.g. stated objectives combined with nature of benefits) could have more weighting than others. S9-SD also commented that 'stated objectives' and 'nature of equity' should be primary indicators because of their objective nature which in turn would assist with the assessment of NFP classifications for members-based organisations or children education providers. S15-LCA commented that the guidance does not provide clear answers and the factors are different to those used in the context of the meaning of 'not-for-profit'.

S5-DH also asserted that "*having a multitude of indicators, as proposed, likely to cause problems in the future as companies get more into corporate social responsibility and virtue signalling…aim to satisfy a multitude of stakeholders not just shareholders."* The respondent also did not find the guidance particularly useful as they considered the examples and guidance inconclusive and as such, unlikely to reduce diversity of application. This respondent also commented that the proposed guidance is confusing and inconclusive, and examples are not particularly useful.

Staff analysis and recommendation

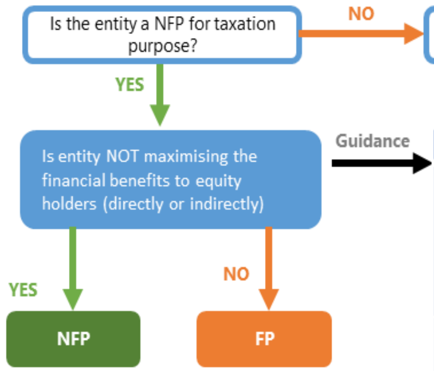
Staff do not consider it appropriate to provide weighting for any specific indicators for entities other than those with NFP status for taxation purpose where the Board decided to provide further guidance to simplify the assessment process for these entities. The Board already considered the interaction of various indicators in the implementation guidance to ED 291, Appendix B, par. 37 "…*in some cases the indicators may conflict with each other and the primary objective or purpose of the entity may not be obvious. Some indicators may indicate that an entity should be classified as a FP entity and others may indicate the entity should be classified as a NFP entity. In this situation professional judgement is required to evaluate the indicator overall and in combination with each other, including the significance of particular indicators to the overall assessment, to determine whether in substance, the entity meets the definition of a NFP entity.*"

To assist entities with the assessment for their classifications, staff considered adding two flowcharts to the beginning of the implementation guidance, for private sector entities with NFP taxation status and other entities respectively.

The Flowchart 1 for private sector entities with NFP taxation status also incorporates the presumption “an entity is an NFP for financial reporting if it is NFP for taxation purposes, unless the entity maximises the financial benefit to equity holders”. As discussed earlier in par. 9, entities with NFP status for taxation purpose would have 1) primary purpose is to provide community and social benefits, which satisfies the first limb of the proposed definition in ED 291; and 2) a non-distribution clause in its constitution document which prohibits it from distributing net income to its equity holders, both during operation and winding up. Therefore, these entities will not need to go through the full implementation guidance to determine whether they are NFP or FP.

However, these entities will still need to assess whether they maximise financial benefits, both directly and indirectly (i.e. via means not violating the non-distribution clause), to equity holders. These entities can distribute financial benefits to equity holders in a number of ways, such as donations or provision of discounted services and rebates.

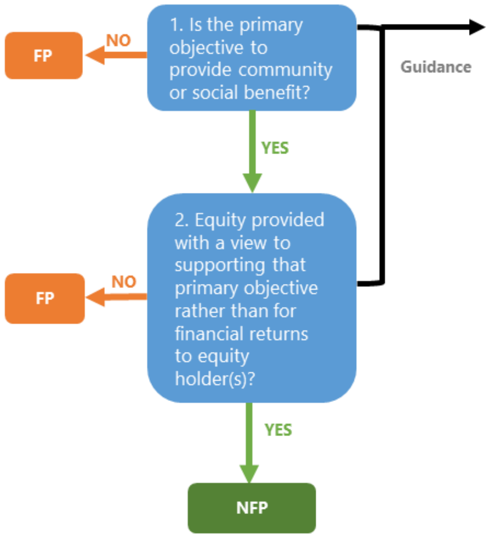
Flowchart 1: Assessment Process for Private Sector Entities self-assessed as NFP for tax purposes



Example	Description
IE FP1	An entity without clearly defined equity instrument (e.g. companies limited by guarantee, trusts, co-operatives etc.) maximising and distributing financial returns to equity holders (either directly or indirectly through related parties) via donations, rebates, discounted services or in another form.
IE FP2	A subsidiary set-up with the aim to maximise returns to its NFP parent and/or related parties. The subsidiary is FP in nature on a stand-alone basis while its parent and/or group may be NFP
IE FP3	An entity with clear objective to maximise financial returns to equity holders irrespective whether the financial benefits are in fact distributed and irrespective of the form of the distribution.
IE NFP	A member-based local sports club providing concessional services to members but not maximising the financial benefits to members.
Notes: The above description provide a brief summary of the examples staff propose to develop. The exact wording for each example is due to be determined.	

The Flowchart 2 for entities other than those with NFP status for taxation purpose, including private sector entities without non-distribution clause and public sector entities, aims to illustrate the steps in the assessment process and summarise the application of the implementation guidance and indicators in the illustrative examples as these entities will need to refer to the implementation guidance to determine their classification.

Flowchart 2: Assessment process for all other entities not covered in Flowchart 1



Indicators	Illustrative Examples			
	IE XX	IE XX	IE XX	(more scenario may be developed following Board's decision)
i). **Stated Objective** Clearly stated objectives for community and/or social in relevant docs?	yes	yes	yes	
ii) **the nature of benefit** (entity NOT exist to generate financial surplus to provide financial benefit, including provision of goods and services, to equity holders?)	no	no	yes	
iii). **The Primary beneficiaries of the benefits**	members of community	equity holders or members only (and high hurdle to become a member)	members of community	
iv). **Nature of equity -** for financial returns to equity holder(s)? (i.e. clear equity instrument?)	yes	no	no	
v). **Purpose and use of asset** for financial returns to equity holder(s)?	yes	yes	no	
vi). **Nature of funding** Are resource provider entitled to (or with the rights to) financial returns?	yes	yes	yes	
Overall assessment for the classification of an entity:	FP	FP	NFP	

In addition to the summarising of the implementation guidance already provided in ED 291, the staff also considered providing an overall assessment of the NFP status for the illustrative examples. Individual indicators were assessed in isolation in the illustrative examples in ED 291. Staff acknowledge that the following proposed approach may depart from the NZ approach, but staff contemplated that analysing the indicators in combination for each scenario provided (while illustrating opposite assessment outcomes, i.e. splitting each example to illustrate FP and NFP assessment outcome) would improve the illustration of how to perform the assessment in practice. This proposed approach recognises the need to apply judgement and the need to evaluate all relevant facts and circumstances of a particular fact pattern when applying the guidance as these may vary significantly from entity to entity. An example of the re-structured Illustrative example is included in Appendix A (based on the current Illustrative Example 1).

Question 5 to the Board:

Does the Board agree that the staff proposed flowcharts reflect the Board's views and should be included in the implementation guidance?

Question 6 to the Board:

Does the Board agree with the staff proposal to re-structure the illustrative examples (as illustrated in Appendix A) and to make them conclusive?

NEXT STEPS

17 Subject to the Board decisions and feedback at April 2020 meeting, staff will provide analysis and recommendations on the matters identified outlined in par. 5 to the Board at its future meetings including any consequential amendments and including consideration whether the proposals need to be re-exposed in line with AASB Due Process guidelines.

Appendix A: Proposed re-structured illustrative example

Example 1: Wholly owned State entity

Entity A is a water and wastewater service provider for certain regional communities, and is a wholly owned State company.

	1A	1B
Stated objectives	Entity is subject to State legislation applying to State-owned companies. The general objectives stated in the legislation are that each State-owned company is to perform its functions for the public benefit by: • operating its business or pursuing its undertaking as efficiently as possible; • maximising its contribution to the economy and well-being of the State; • exhibiting a sense of social responsibility; • operating in accordance with the principles of ecologically sustainable development where its activities affect the environment; and • exhibiting a sense of responsibility towards regional development and decentralisation in the way in which it operates.	
Nature of the benefits, including the quantum of expected financial benefits	The provision of water and wastewater services would result in community and social benefit for the particular regional communities receiving such services. Entity A may be required to charge customers at discounted rates, or to reinvest its surplus to facilitate regional development and infrastructure or otherwise in the public interest, and meet non-financial performance targets (such as the level of service to customers) rather than targeting a financial return to its equity holder.	Entity A may operate under a government business model or policy framework requiring it to charge customers at commercial rates with the intention of generating a financial return for its equity holder (the State Government) or meeting financial and efficiency performance targets. This may indicate that Entity A is a FP entity.
Primary beneficiaries of the benefits	Although Entity A is a company, the primary beneficiaries may not be the State government. If Entity A is required to reinvest any surplus to facilitate regional development and infrastructure or otherwise in the public interest, the primary beneficiaries would be the broader regional communities receiving the services, which may indicate that Entity A is a NFP entity.	If Entity A operates on a commercial basis for the purpose of providing a financial return to the State Government (ie the equity holder), then the primary beneficiary would be the entity’s equity holder, which may indicate that Entity A is a FP entity.
Nature of equity interest	If the company constitution (or other governing framework) provides that in the event Entity A is wound up, or otherwise ceases to operate, its net assets are required to be transferred to another entity with a similar purpose, this may indicate that Entity A is a NFP entity.	Entity A is a company. The equity interest is in the form of shares owned by the State Government. In the case of Entity A, the nature of the equity interest is clear. In addition, there may not be any restriction on the use of assets in the event Entity A is sold, wound up or ceases to operate. This may indicate that Entity A is a FP entity.
Purpose and use of assets	Entity A owns property, plant and equipment that it uses to provide water and wastewater services.	
	If the property, plant and equipment is used primarily for providing water and wastewater services or enhancing infrastructure for the benefit of the regional communities it services, this may indicate that Entity A is a NFP entity.	If Entity A holds those assets to operate or sell in order to generate a commercial financial return for the State government, this may indicate that Entity A is a FP entity.
Nature of funding	Entity A competes for funding from government and private sources.	
	If funding is derived through a mix of government grants and discounted or subsidised fees, this may indicate that Entity A is a NFP entity.	If Entity A funds its activities primarily through charging commercial fees to customers for services rendered, this may indicate that Entity A is a FP entity.
Overall assessment	The above factors indicate that Entity A is a NFP entity.	The above factors indicate that Entity A is a FP entity.