



To:	AASB members	Date:	24 August 2009
From:	Jessica Lion/Angus Thomson	Agenda Item:	4.2.1
Subject:	Not-for-profit entity definition	File:	

Action

Reconsider whether the definition of ‘not-for-profit entity’ needs to be updated and whether guidance should be issued in respect of this definition.

Background

In December 2007 the AASB issued ITC 14 ‘Proposed Definition and Guidance for Not-for-Profit Entities’. This incorporated the New Zealand FRSB terminology, definition and guidance regarding ‘public benefit entities’ and asked constituents to comment on whether they believed these terms and guidance were relevant to the Australian environment. The responses received from comment letters and round tables held were debated at the May 2008 Board meeting. At that time the Board concluded that:

- (a) the project should be dealt with as part of the criteria being developed for determining when it might be appropriate to permit or require a departure from IFRSs in respect of not-for-profit entities (this project has resulted in draft: *Process for Modifying IFRSs for PBE/NFP*);
- (b) there is not a sufficient basis for changing from the existing term ‘not-for-profit entity’;
- (c) as a working principle, the existing content of the definition should be used;
- (d) draft guidance should be developed using a range of sources, including the guidance prepared by the New Zealand FRSB, the Heads of Treasuries Accounting and Reporting Advisory Committee and the Australasian Council of Auditors-General; and
- (e) it be proposed that not-for-profit entities disclose their status in certain circumstances.

Staff note that current standards define a not-for-profit entity as “an entity whose principal objective is not the generation of profit. A not-for-profit entity can be a single entity or a group of entities comprising the parent entity and each of the entities that it controls.” As noted above it was decided in the May 2008 meeting that the term ‘not-for-profit entity’ should be retained. Staff recommend that this decision is maintained, however staff have reconsidered the definition of ‘not-for-profit’ and developing guidance as requested above.

Staff considered the range of sources listed in point (d) above, as well as the ‘Report for CPA Australia Centre of Excellence for Financial Reporting and Governance – Defining a Not-For-Profit Entity in Australia – The Accounting Perspective’. There are many common themes throughout these sources and staff have used these to identify two possible approaches. Both approaches include rebuttable presumptions.

Approach 1: Define and have guidance re ‘for-profit’ entities:

An entity would be presumed to be ‘for-profit’ if the following two factors exist:

- the law/regulation/constitution states that the entity’s primary objective is the generation of profit in order to provide equity holders with a return, or the entity’s business model is designed and operates with that objective; and
- any surplus generated is available to be distributed to equity holders.

Other factors that may indicate that an entity is ‘for-profit’ if it is not clear from the two factors above are:

- the entity does not receive significant amounts of cash in non-exchange transactions, such as government funding or donations, on an ongoing basis;
- the entity is subject to income tax; or/and
- the GFS classification of the entity (e.g. as a Public Financial Corporation (PFC)).

Approach 2: Define and have guidance re ‘not-for-profit’ entities:

An entity would be presumed to be ‘not-for-profit’ if the following three factors exist:

- the law/regulation/constitution states that the entity’s primary objective is not the generation of profit in order to provide equity shareholders with a return;
- the entity’s business model is designed and operates to meet a mission (or equivalent) other than the generation of profit in order to provide equity shareholders with a return; and
- any surplus generated is reinvested in the entity rather than being available for distribution to equity holders (this includes restrictions on the distribution of any surplus upon winding-up).

Other factors that may indicate that an entity is ‘not-for-profit’ if it is not clear from the three factors above are:

- the entity receives significant amounts of cash in non-exchange transactions, such as government funding or donations, on an ongoing basis;
- the entity is not subject to income tax and/or the entity has ‘designated gift recipient’ status; and
- the GFS classification of the entity (i.e. as a General Government Sector entity (GGS)).

The reason for suggesting these changes to the definition, are the concerns raised by constituents that many ‘not-for-profit’ entities will aim to be commercial and generate a profit on a day to day

basis, with a view to being efficient with its available resources and to maximise the resources available to fund as many ‘not-for-profit’ activities as possible.

On balance staff recommend that the Board adopts approach one as some constituents had concerns that the term ‘not-for-profit’ implied negative connotations and hence suggested defining ‘for-profit’ instead.

Staff suggest that if the Board does not agree to one of the two proposed approaches above, at a minimum the definition of a not-for-profit entity should be changed to:

“an entity whose principal objective is not the generation of profit in order to provide a financial return to equity holders.”

Staff also recommend removing the second sentence in the current definition (“A not-for-profit entity can be a single entity or a group of entities comprising the parent entity and each of the entities that it controls”) and replacing it with wording similar to the New Zealand guidance (as this is more useful). The New Zealand guidance states:

‘Not-for-Profit entities may establish subsidiaries or discrete business units which operate to generate a return that can be used to support the primary activities of the parent entity. Such entities or business units may be profit-orientated. This fact does not affect the classification of the parent or group entity.’

Attachments

- 4.2 Appendix A to NZ IAS 1 (Guidance prepared by the New Zealand FRSB)
- 4.3 Heads of Treasuries Accounting and Reporting Advisory Committee Guidance on Distinguishing For-Profit from Not-for-Profit
- 4.4 Guidance on determining whether a government entity is not-for-profit or for-profit prepared by the Australasian Council of Auditors General Advisory Committee
- 4.5 Defining a Not-for-Profit entity in Australia -The Accounting Perspective (Report for CPA Australia)