

9 September 2019

Ms Kris Peach
Chair
Australian Accounting Standards Board
PO Box 204
Collins Street West
Victoria 8007

Submission via aasb.gov.au

Dear Kris

Not-for-Profit Entity Definition and Guidance (ED 291)

As the representatives of over 200,000 current and future professional accountants in Australia, the two major Australian accounting bodies, Chartered Accountants Australia and New Zealand (Chartered Accountants ANZ) and CPA Australia (together 'the Major Accounting Bodies'), thank you for the opportunity to comment on the above Exposure Draft ('the ED').

We support the Australian Accounting Standards Board (AASB) initiative to develop and introduce a new 'not-for-profit' (NFP) definition and associated guidance. We agree with the AASB's proposal to retain the term 'not-for-profit' and with the AASB's view that the current definition does not adequately describe the nature of NFP entities that operate in Australia. We also agree that Australian accounting standards need a clearer and more robust definition of the term 'not-for-profit', particularly as the AASB seeks to develop a separate, fit-for-purpose NFP financial reporting framework in the near future.

Whilst we support the AASB's approach to adopt and adapt the New Zealand definition of a "Public Benefit Entity" (PBE) for Australian purposes, there is a potential conflict between the ED's proposed NFP definition for financial reporting purposes and the legal meaning of the term 'charity' as it is used in Australia. Charity law states that all charities are NFPs but feedback we have received indicates that a few hundred charities currently registered with the Australian Charities and Not-for-profits Commission (ACNC) may encounter difficulties with the current wording of the NFP definition and guidance, despite having recognised charity status under law.

Therefore, we make the following two suggestions to address the potential conflict:

- Revise the implementation guidance to explicitly state that all charities will meet the NFP definition. While the proposed NFP definition in itself may provide sufficient flexibility to allow all charities to meet the definition, the implementation guidance, including the examples, provides a restrictive interpretation that could result in precluding some charities from classifying themselves as NFPs.
- Delay finalising the NFP definition and guidance until the AASB's NFP financial reporting framework project is concluded. Given the significance of this framework project, it would be beneficial to ensure both the "who" should report, and "what" should be reported are determined concurrently, in order to facilitate the identification of any further implementation issues.

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We also request the AASB considers other NFP scenarios (e.g. member organisations where members are the primary beneficiaries) that may give rise to a potential conflict similar to that identified above affecting charities.

We have provided our responses to the specific and general matters for comment in the **Attachment**. If you have any questions about our submission, please contact either Amir Ghandar (Chartered Accountants ANZ) amir.ghandar@charteredaccountantsanz.com or Ram Subramanian (CPA Australia) at ram.subramanian@cpaaustralia.com.au.



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ATTACHMENT

Specific matters for comment

1. **Do you agree that the current definition of not-for-profit entity in Australian Accounting Standards should be replaced with the proposed definition, which is based on the New Zealand definition of public benefit entity? Please indicate your reasons.**

Yes, we agree with the proposal to replace the current definition with a more accurate definition that reflects the nature of the NFP sector. Whilst we support the proposed approach to adopt and adapt the New Zealand definition of a 'Public Benefit Entity' (PBE), we recommend the AASB focus more closely on the Australian specific issues that may arise from this approach as highlighted in the cover letter and detailed in the response to Question 2 below.

2. **Do you agree with the proposed implementation guidance and illustrative examples? Why, or why not? Please indicate any concerns about particular parts of the guidance, or particular examples.**

Whilst we support the AASB's approach to adopt and adapt the New Zealand definition of a PBE for Australian purposes, the proposed definition and implementation guidance gives rise to a potential conflict. Appendix B, paragraph 5 states that "...it is possible for a registered charity to be classified as a FP [for-profit] entity for financial reporting purposes". However, the definition of 'charity' set out in the Charities Act 2013, section 5 states that "charity means an entity: (a) that is a not-for-profit entity...". Although the term 'not-for-profit' is not defined in the Charities Act, the definition of charity in the Charities Act codifies in statute the previous common law position that charities are also not-for-profits.

Feedback we have received indicate a few hundred charities currently registered with the Australian Charities and Not-for-profits Commission (ACNC) may encounter difficulties with the current wording of the proposed NFP definition and guidance, despite having recognised charity status under law.

We therefore make the following two suggestions to address the potential conflict:

- Revise the implementation guidance to explicitly state that all charities will meet the NFP definition. While the proposed NFP definition in itself may provide sufficient flexibility to allow all charities to meet the definition, the implementation guidance, including the examples, provides a restrictive interpretation that could result in precluding some charities from classifying themselves as NFPs.
- Delay finalising the NFP definition and guidance until the NFP financial reporting framework project is concluded. Given the significance of this framework project, it would be beneficial to ensure both the "who" should report, and "what" should be reported are determined concurrently in order to facilitate the identification of any further implementation issues.

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In light of the above concerns, the wording of the illustrative examples provided need to be reconsidered to ensure that these legislative conflicts are dealt with. In particular, we have concerns with Example 2: Bicycle Shop, which sets out a scenario where a bicycle shop owned by a charitable trust may need to classify itself as a FP entity.

We request the AASB also considers other NFP scenarios (e.g. member organisations where members are the primary beneficiaries) that may give rise to a potential conflict similar to that identified above affecting charities. The AASB's intention to bifurcate for-profit (FP) and NFP financial reporting frameworks going forward means that the decision made by an entity whether it is a FP or NFP entity could have a significant impact on the financial reporting framework choice available to that entity. Issues of consistency and comparability will also be relevant, to ensure entities with similar attributes are classified similarly.

Paragraph 28 of Appendix B states that "If the entity is membership based and the primary beneficiaries of the benefits provided by the entity are not members of the entity, the entity is likely to be an NFP entity". This suggests that if the primary beneficiaries are members of the entity, the entity may not be an NFP entity. Many NFP entities can be membership organisations whose primary objective is to provide benefits to members (e.g. golf clubs or similar member-based associations). The same paragraph also states "However, if the primary beneficiaries are members of the entity, it is necessary to consider other factors to determine whether the entity is an NFP entity (for example, the nature of the benefits and other indicators in this guidance)". It would be helpful if clarification was provided within the implementation guidance as to what other factors should be taken into consideration when determining whether a membership-based organisation is an NFP entity or not. An illustrative example based on membership organisations would also be helpful.

3. Do you agree that in determining the classification of a group that it is necessary to consider the characteristics of the group and the controlling entity? Do you agree that the classification of the controlling entity of the group would most likely determine the classification of the group? Why, or why not?

Yes, we agree that it is important to consider both the characteristics of the group and the controlling entity in order to determine whether it is an FP or NFP entity. We also agree that the purposes of the controlling entity are likely to be the key determinant because it is the characteristics and objectives of this entity that are likely to have driven the creation of the group in the first place. Accordingly, where a subsidiary within a group operates as a business and may not itself meet the definition of an NFP entity, the characteristics of its parent entity, which may meet the definition of an NFP entity may need to be taken into consideration when determining the classification of the subsidiary entity.

4. Do you agree with the proposed guidance on the accounting consequences for an entity that changes its classification as a for-profit entity or a not-for-profit entity? Is this guidance sufficient? Why, or why not?

Since the consequences for an entity changing its classification could be significant, we suggest revisiting the guidance to address the legislative issues we have raised above. We also recommend delaying the implementation of these reforms until the financial reporting framework project is concluded in order to better identify any further need for guidance.

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5. No transition requirements have been proposed for the initial adoption of the guidance. Are initial transition provisions required, and if so, what should they state?

As stated above and in the cover letter, we believe the further development and implementation of the new NFP definition and guidance should occur concurrently with the development of the NFP financial reporting framework. The need for any transitional requirements are likely to become evident as the NFP financial reporting framework is developed.

6. Do you agree that the definition and associated guidance should be included in AASB 1057 *Application of Australian Accounting Standards*? Why, or why not? If not, please indicate your preferred approach.

Subject to our above comments, we agree with the proposed approach to include the NFP definition and guidance in AASB 1057.

7. Do you agree that the implementation guidance should form an integral part of AASB 1057, i.e. have mandatory status? Please indicate your reasons.

Subject to our above comments, we agree that guidance is necessary for consistent interpretation and understanding of the NFP definition and therefore should have mandatory status as an integral part of AASB 1057. The NFP definition and guidance will have a crucial role in Australia's differential reporting framework requirements that are currently under development by the AASB.

General matters for comment

8. Whether the AASB's *Not-for-Profit Entity Standard-Setting Framework* has been applied appropriately in developing the proposals in this Exposure Draft?

The standard-setting frameworks (FP and NFP) require a "transaction neutral" approach to standard-setting by the AASB, unless there is a justifiable reason not to do so. While the proposed NFP definition and guidance itself may not give rise to a divergence from the transaction neutral approach to standard-setting, the subsequent development of a fit-for-purpose NFP financial reporting framework which the new NFP definition will underpin, could cause divergence from the transaction neutral approach to standard-setting by the AASB. Such divergence needs to be clearly explained and justified as the framework is developed.

9. Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, including Government Finance Statistics (GFS) implications?

We have highlighted potential regulatory issues that may arise in our cover letter and in our responses to specific questions.

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10. Whether, overall, the proposals would result in financial statements that would be useful to users?

We are unable to comment at this stage whether the proposals would result in financial statements that would be useful to users as this is dependent on the further development of this definition and guidance within the wider NFP reporting framework.

11. Whether the proposals are in the best interests of the Australian economy?

Subject to addressing the concerns we have raised in this submission the proposals are likely to be in the best interests of the Australian economy.

12. Unless already provided in response to specific matters for comment above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative?

No comment.

13. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

No comment

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