



9 September 2019

Australian Accounting Standards Board
PO Box 204
Collins St West
MELBOURNE VIC 8007

By email: standard@asb.gov.au

Dear Sir/Madam

AASB Exposure Draft – Not-for-Profit Entity Definition and Guidance

1. The Law Council welcomes the opportunity to provide comments to the Australian Accounting Standards Board (**AASB**) on the Exposure Draft of the Not-for-Profit Entity Definition and Guidance.¹ This submission has been prepared by Not-for-Profit Legal Practice and Charities Group of the Law Council's Legal Practice Section (**the Committee**).
2. The Committee notes that the AASB is proposing to replace the definition of 'not-for-profit entity' with the following:

*An entity whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders.*²
3. Currently, the AASB defines a not-for-profit entity as 'an entity whose principal objective is not the generation of profit'.³
4. The term 'not-for-profit entity' is particularly relevant for organisations seeking to register as a charity with the Australian Charities and Not-for-profits Commission (**ACNC**), or to otherwise access tax concessions that are available to certain not-for-profit entities.
5. There have been attempts to provide a legislative definition in the past, but given the difficulty in providing a clear definition, those attempts have failed. As a result, the ACNC and the Australian Taxation Office (**ATO**) rely on the traditional meaning of not-

¹ The Law Council of Australia is a peak national representative body of the Australian legal profession. It represents the Australian legal profession on national and international issues, on federal law and the operation of federal courts and tribunals. The Law Council represents 60,000 Australian lawyers through state and territory bar associations and law societies, as well as Law Firms Australia.

² Australian Accounting Standards Board, *Exposure Draft – Not-for-Profit Entity Definition and Guidance* (June 2019) 4, 10.

³ *Ibid.*

for-profit, which focuses on the entity not operating for the profit or gain of certain people (in particular, its members).⁴

6. The ATO describes a not-for-profit organisation as ‘an organisation that is operating for its purpose and not for the profit or gain (either direct or indirect) of its individual members’⁵ and states that:

*We will accept your organisation as an not-for-profit if [your] governing documents prevent you from distributing profits or assets for the benefit of specific people - both while it operates and when it winds up.*⁶

7. The ACNC guidance provides the following:

*Generally, a not-for-profit is an organisation that does not operate for the profit, personal gain or other benefit of particular people (for example, its members, the people who run it or their friends or relatives). The definition of not-for-profit applies both while the organisation is operating and if it ‘winds up’ (closes down).*⁷

8. These interpretations are generally well understood by not-for-profits.
9. The proposed definition is a significant departure from the accepted understandings of the term ‘not-for-profit entity’.
10. It is noted that in New Zealand (**NZ**) the definition proposed by the AASB is used for the expression ‘Public Benefit Entities’ (**PBEs**) and reference is then made to public sector PBEs and **not-for-profit** PBEs. The definition in NZ is not designed to replace the definition of not-for-profit but to include not-for-profits and other for profit entities within a different expression.
11. The Committee considers that it will be confusing to conflate the public benefit entity definition into a not-for-profit definition when as a result, ‘not-for-profit’ has several different meanings depending on the context it is used.
12. For accounting purposes, the proposed definition would include some organisations that are considered to be for-profit and exclude some organisations that are currently considered to be not-for-profit by the ATO and ACNC.
13. The proposed definition itself is not clear as it uses concepts which will require further explanation such as:
 - (a) ‘primary objective’ rather than ‘principal’ purpose or object; and
 - (b) ‘for community or social benefit’ rather than for public benefit.

⁴ See, eg, Australian Taxation Office, *Income tax: Exempt Sporting Clubs* (TR 97/22) [9], [10].

⁵ Australian Taxation Office, ‘Starting an NFP’ (Web page, 20 November 2018) <<https://www.ato.gov.au/Non-profit/Getting-started/Starting-an-NFP/>>.

⁶ Australian Taxation Office, ‘What Type NFP is your organisation?’ (Web page, 19 June 2017) <<https://www.ato.gov.au/Non-profit/Getting-started/What-type-of-NFP-is-your-organisation/>>.

⁷ Australian Charities and Not-for-profits Commission, ‘Not-for-profit’ (Web page) <<https://www.acnc.gov.au/for-charities/start-charity/not-profit/>>.

14. The proposed definition is also unclear as to whether:
 - (a) it only applies to entities which provide goods or services, or whether it can be read to apply to entities which provide social benefit; and
 - (b) 'equity holder' only means a shareholder or also includes a member of an entity without shares.
15. The guidance does not provide any simple or clear answers, but rather, involves the complex weighing up of a number of (often competing) factors. The factors are different to those they are used to considering in the context of the meaning of 'not-for-profit'.
16. For charities, and other not-for-profit organisations, this additional assessment unnecessarily adds to the complicated and inconsistent regulatory environment in which they already operate.
17. In the view of the Committee, this is undesirable as it creates confusion, inconsistency, additional red tape and undermines the policy rationale for the establishment of the ACNC.
18. If the AASB considers that accounting standards should apply to a particular group in the same way that they do to not-for-profit entities then, in the Committee's view, it should, rather than broadening the definition of 'not-for-profit' entity, create a new category that sits along-side the definition of not-for-profit. For example, it could apply the relevant standards to a 'not-for-profit entity' (using the more traditional definition) and a 'public benefit entity' (using the proposed definition). Doing so would avoid confusion and inconsistent use of the term 'not-for-profit entity'.

Charities which would not be caught in the definition

19. Some charities will no longer be 'not-for-profit entities' under the proposed definition.
20. The concept of 'providing goods or services' is a new approach to the concept of not-for-profit. Many well recognised categories of not-for-profit organisations may not meet this requirement. 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. In this way, the proposed definition is narrower than the traditional concept as accepted by the ACNC and ATO.
21. All charities must operate for the public benefit except those which provide relief of necessitous circumstances (so many of these charities would be excluded from the proposed definition). The Committee queries whether public benefit would have the same meaning of 'community or social benefit'?
22. Some charities provide money or benefits to their members as a means of carrying out their charitable purposes, for example, where their members are clients of the charity or when the members are themselves charities. However, under the proposed definition these entities may not come within the proposed not-for-profit definition.
23. In addition, some charities provide goods and services which are not directly related to community or social benefit, but the profits generated from the provision of these goods and services are used to support a charitable purpose (for example, through donating the funds to a charity). In this case, the goods and services are more directly

provided in order to generate profits. As such, although the ultimate objective of the charity is to support charitable purposes for the public benefit, it may not fit within the proposed definition. Indeed, the implementation guidance notes that 'it is possible for a registered charity to be classified as a for-profit (**FP**) entity for financial reporting purposes'. In the view of the Committee, there are a number of reasons that all registered charities should report under the same reporting framework:

- (a) generally, a charity's only or main financial reporting obligations are to the ACNC. As such, it is unclear why different reporting standards should apply to entities that the ACNC considers are all not-for-profit. Part of the policy rationale for the establishment for the ACNC was to have all charities reporting to one regulator, irrespective of their corporate structure or the area in which they operate. This was partly to allow consistency across the sector, and an ability for the public to access comparable information about charities. In accordance with these policy objectives, all charities should report under the same framework; and
- (b) further, charities that have established their not-for-profit status with the ACNC (through registration) should not be subject to the additional burden of assessing their status as a not-for-profit under a different definition used by the AASB. Requiring them to do so would create additional red tape and confusion for charities. Indeed, part of the purpose of the ACNC is to work with other government regulators to establish a consistent reporting framework for charities and to reduce red tape for charities. The proposed definition would undermine these policy objectives.

For-profits which will be caught in the definition

24. Some FP entities will be considered to be 'not-for-profit entities' under the proposed definition which may be misleading to members of the public and other entities when dealing with these FP entities.
25. The proposed definition is wider than the traditional concept in the following ways:
 - (a) it implies that a not-for-profit entity may have a purpose of operating for the profit or gain of members, as long as that purpose is not its primary objective. Under the ACNC and ATO definitions, a not-for-profit entity may not have a purpose of providing profit to its members (unless its members are themselves charities and the funds are provided in furtherance of the not-for-profit's purpose). Any profit made is to be used to further its purpose, and as such, is not an independent purpose in itself, but rather, incidental or ancillary to its purpose; and
 - (b) the issuing of equity would ordinarily be seen as inconsistent with the concept of a not-for-profit entity (unless there was no mechanism for profit distributions to be made). As such, it is likely that organisations that the ATO and ACNC would consider to be FP entities could be not-for-profit entities under the proposed AASB definition.
26. In summary, it would be confusing for the AASB to adopt a definition of not-for-profit that deviates so significantly from the traditional understanding of the term. The definition should be, so far as possible, consistent with that used by the ACNC and the ATO. Further, all charities should report under a consistent framework.

27. The Committee is grateful for the opportunity to provide this input in relation to the Consultation Paper. If you require further clarification, please contact the Chair of the Committee, Ms Jennifer Batrouney QC, at Jennifer_Batrouney@vicbar.com.au or on (03) 9225 8528.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Jonathan Smithers', with a long horizontal stroke extending to the right.

Jonathan Smithers
Chief Executive Officer