

17 January 2018

Chair
Australian Accounting Standards Board
PO Box 204
Collins St West
VICTORIA 8007

via online submission

Dear Ms Peach

AASB Invitation to Comment – The AASB’s Standard-Setting Frameworks for For-Profit Entities and Not-for-Profit Entities

Thank you for the opportunity to provide a submission to the Australian Accounting Standards Board (**AASB**) on *The AASB’s Standard-Setting Frameworks for For-Profit Entities and Not-for-Profit Entities (ITC)*.

The Australian Institute of Company Directors (**AICD**) is committed to excellence in governance. We make a positive impact on society and the economy through governance education, director development and advocacy. Our membership of more than 42,000 includes directors and senior leaders from business, government and the not-for-profit sectors.

The AICD welcomes the AASB’s focus on clarifying and simplifying the Australian Financial Reporting Framework (**AFR Framework**) and notes that the ITC is related to this work. However, the AICD is concerned that the ITC consultation is premature given the fundamental changes expected to the AFR Framework.

The AICD submits that it would be more appropriate to consult on the overarching standard-setting frameworks for for-profit and not-for-profit entities once the AFR Framework review has been completed.

Notwithstanding this position, our comments on the ITC consultation questions are set out below.

1. Is the term “not-for-profit” helpful to understand the nature of the entities in that sector? If not, what other term do you consider is more appropriate?

The AICD is satisfied with the use of the term ‘not-for-profit’ (**NFP**) in a general sense and does not support an alternative term. Although the term NFP is imperfect, we do not believe there is a superior alternative. The problems that changing the term would seek to address are not inconsequential, but they cannot be solved simply by changing a name.

The AICD has undertaken detailed analysis of this issue, including an opinion poll of our members, and published the results in a 2017 position paper titled *What’s in a name: Use of the term ‘not-for-profit’*.

This paper considers the broad use of the term and not just its accounting use. It concludes that the term, NFP, should not be changed because:

- There is no significant support in the sector, particularly from those in leadership roles, to bring about the change;
- The term is too deeply embedded in policy and regulation (not just in accounting standards) and it is unrealistic to expect the inter-governmental agreement, coordination and commitment of resources required to change the term;
- There is no obvious alternative term; and
- The use of a different term for marketing purposes only (in contrast to that used in a policy and regulatory sense) could create further complexity and uncertainty.

However, the AICD does support re-defining the term 'NFP' within the context of accounting standards. 'NFP' is defined in the ITC and various accounting standards as 'an entity whose principal objective is not the generation of profit'. The ITC then introduces a definition of for-profit entity (**FP**), being an entity whose 'principal objective is the generation of profit'.

In the view of the AICD, these definitions are inappropriate as their binary focus on a primary profit-related objective does not reflect the operating reality of all entities. For example, some entities arguably have dual or multiple objectives, such as generating a profit to fund 'for-purpose' activities. Other entities may exist merely for a specific operational, strategic or tax advantage. Yet other organisations, typically characterised as FP entities, may consider their primary objective to be long-term value creation.

Another complicating factor with profit-based definitions is the confusion it creates for some organisations, particularly some NFPs. All organisations must seek to generate some profit, otherwise they will be unsustainable (refer to the AICD's 2017 *NFP Governance and Performance Study* for more information on this). While this may not be their primary purpose, having a NFP definition based on the absence of a primary focus on profit generation leads some charities and other NFPs to mistakenly believe they are not 'entitled' to make a profit. We appreciate that this issue is exacerbated by the use of the term 'NFP', but believe that definitions which do not centre on the presence or absence of a primary profit goal, would go some way to addressing this issue.

We acknowledge that crafting definitions of NFP and FP entities is complex, and we are not able to articulate a clear solution at this time. However, we suggest the AASB research how these entities are defined in other jurisdictions with a view to identifying useful concepts employed overseas. Alternatively, the AASB may wish to consider the usefulness of the NFP definition used by the Australian Taxation Office, being 'an organisation that is operating for its purpose and not for the profit or gain (either direct or indirect) of its individual members'.

Further, many co-operatives and mutual entities (**CMEs**) conduct business activities for the benefit of the community and/or members, competing directly with other entities that have a primary objective of generating a profit. Other CMEs are considered to be publicly accountable, having debt or equity instruments or holding significant assets on behalf of others. While these entities meet the current definition of a NFP, they are not charitable in nature, being more aligned in operations and nature to FP entities currently applying IFRS. Any change to the definition of NFP should specifically consider the appropriate reporting framework for CMEs based on user needs. We consider that if a NFP entity wishes to report in a manner comparable to its FP competitors and comply with IFRS, the AASB definitions of NFP and FP entities would ideally accommodate this situation.

2. Is there enough guidance about which entities are for-profit entities and not-for-profit entities?....Should the AASB work with NZASB on improving guidance?

As noted in the above response, we consider the ITC definition of a NFP requires amendment. Any change to the definition should be accompanied by guidance on how to apply the new definition, especially if the definition is principles-based.

Working with NZASB on improving guidance would be appropriate only if the definition developed in Australia is similar to that applying in New Zealand.

3. Do you have any other comments on the AASB's draft Standard-Setting Frameworks?

In our view, the ITC does not fully explore all relevant issues. These issues include the following:

Role of the AASB

Certain AASB standards apply both to general purpose financial statements and special purpose financial statements. Accordingly, we do not agree with the following statement made in the ITC:

'The AASB sets standards only for general purpose financial statements'.

For entities required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act 2001, the standards applying to both special purpose financial statements and general purpose financial statements include:

- AASB 1057 *Application of Accounting Standards*;
- AASB 1054 *Australian Additional Disclosures*;
- AASB 1053 *Application of Tiers of Australian Accounting Standards*;
- AASB 101 *Presentation of Financial Statements*; and
- AASB 108 *Accounting Policies, Change in Accounting Estimates and Errors*.

Similar requirements exist through regulation for entities reporting to the Australian Charities and Not-for-profits Commission.

In our view, the AASB's mandate, as expressed in the ITC, should recognise that the AASB may develop special purpose standards for entities other than reporting entities, such as for proprietary companies or charities/associations below public reporting thresholds. .

Transaction neutrality

The ITC does not ask any question about the current application of 'transaction neutrality', noting only that it is an assumption. The AICD generally supports the assumption of 'transaction neutrality' based on the current 'reporting entity' concept outlined in Statement of Accounting Concept 1 *Definition of a Reporting Entity*. However, the AICD is concerned that the assumption may be applied or not applied, as the case may be, in a manner that places an unreasonable burden on the NFP sector. Two examples are provided to highlight this issue:

- Application example – While the new leasing standard and peppercorn lease arrangements are transaction neutral, they create an unreasonable burden for NFPs without any clear user need or benefit. Many NFPs have peppercorn lease arrangements and will be required to incur additional costs to measure these at fair value in accordance with the requirements of the new leasing standard. The AICD considers that this burden is unreasonable for NFPs and that disclosure would be sufficient for

user needs, rather than requiring the determination of values and the recording on NFP balance sheets. AICD does not believe any expected benefits are warranted by the cost.

- Non-application example – Aged care providers can be NFPs or FPs. Although FP aged care providers are required to measure bed licences at cost, NFP aged care providers are required to report bed licences at their fair value from the date of acquisition (even if donated). The AICD considers that this burden of determining fair value is unreasonable for NFPs and not transaction neutral with the FP sector.

Where transaction neutrality combined with any future removal of special purpose financial reporting would result in an increase in compliance burden for many non-publicly accountable entities, we recommend the AASB considers forgoing ‘transaction neutrality’ as an assumption and explores the possibility of IFRS for SMEs (or similar) being introduced to provide a simpler form of financial reporting. Jurisdictions that are well respected by Australia, such as the United Kingdom and New Zealand, have done this and we recommend that the AASB also explore this approach.

Structure and content issues

The AICD believes there is scope to improve the structure and content of the ITC frameworks. Our suggestions are set out in Annexure A.

We hope our comments will be of assistance to the government. If you would like to discuss any aspect of this submission, please contact Ms Kerry Hicks, Senior Policy Adviser, on (02) 8248 6635 or at khicks@aicd.com.au.

Yours sincerely



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FP standard-setting framework

The ITC attempts to define this framework, separating those entities that are publicly accountable from those that are not. It then discusses triggers for Australian-specific for-profit standards or guidance plus 'justifications' for Australian-specific standards or guidance. It then proceeds to identify the significance of the issues, and then discusses how anything Australian-specific will be developed.

We found the way this is documented very confusing, and lacking internal consistency. For example the AASB objective (d) for publicly accountable entities seems to be expanded into (b) and (c) for 'Other FP entities', without a clear understanding as to why this is documented differently.

Other areas for improvement include:

- It would also be helpful for this document to provide a sense of the type of entities that are publicly accountable versus those that are not publicly accountable;
- We also consider that example justifications should not be included within the AASB objectives area. Rather, we suggest that these be detailed and clearly cross referenced within the section on justifications;
- IFRS compliance may be just as important for 'Other FP entities' and this is not recognised in the ITC;
- Another way of simplifying the document may be to merge the triggers and justifications together;
- Cross referencing within the framework could be clearer; and
- This document would benefit from being written in 'plain English' to allow it to be understood more broadly.

What was also not clear in the material is the current approach of the AASB to recognition and measurement exceptions. For example, the paper could broadly describe the exceptions that exist for NFPs. Further, it could explain that the main area of difference is with disclosures (to accommodate the Reduced Disclosure Requirements) plus some additional disclosures due to them being Australian specific.

NFP standard-setting framework

We consider that this framework could be improved in similar manner to that suggested above for the FP standard-setting framework.

The ITC documents this framework as separate to the FP framework. In our view this is unnecessary as the two frameworks are very similar, except for a number of recognition and measurement differences. Our preference is for a single framework with a rationale provided for the recognition and measurement differences.

Further, one particular area of focus for the AASB outside of the listed sector is to determine user needs. This is critical since this is not catered for by the International Accounting Standards Board as they concentrate on entities in the capital market. We would see this as a critical role in the standard setting process and would like to see this recognised in the ITC.

While we note that the AASB stakeholder engagement strategy has increased in the last two years, we consider the AASB should undertake further engagement with the sector on the identification and engagement of users of NFP financial reports.