

17 January 2018

Ms Kris Peach
Chair and Chief Executive Officer
Australian Accounting Standards Board
(Submitted via AASB website)

Dear Ms Peach

ITC 37 – October 2017: AASB Standard-Setting Frameworks for For-Profit and Not-for-Profit Entities

Thank you for the opportunity to provide comment on the AASB's proposed standard-setting frameworks for for-profit (FP) entities and not-for-profit (NFP) entities.

Customer-owned banking institutions are currently FP entities for the purposes of preparing financial statements.¹ COBA believe that they must remain so under any future framework. While our sector's principal objective is to provide financial accommodation (services) to members, it still retains a primary need for profit generation and does not share the typical characteristics of an NFP. Generating profit is essential for customer-owned banks as it is the main way to raise the regulatory capital required to allow the institution to grow without excessive leverage. It is also unlikely that the NFP framework would meet the needs of users of our financial statements.

COBA is concerned that the definition of FPs as "entities whose principal objective is the generation of profit" may be too narrow and could inadvertently exclude customer-owned banking institutions.

About the customer-owned banking sector

Customer-owned banking institutions are owned by their customers rather than a separate group of investor shareholders. For these institutions, the principal objective is providing financial accommodation and benefits to customer-owners rather than the generation of profit for equity holders. This does not preclude investors providing equity as long as the dominant purpose of the company does not become yielding a return to investor shareholders. Customer-owned institutions provide benefits to members through better value products that are provided at competitive market prices and are funded by deposits or borrowing where a financial return is paid for contributed resources.

Our institutions generally have multiple objectives: to provide financial products to customer-owners over the long term while also generating profits to underpin institutional growth and longer-term benefits to customer-owners. As previously noted, the generation of profit is unlikely to be the principal objective of our institutions, but is likely to be among the primary objectives.

¹ COBA member financial statements typically disclose that they are 'for-profit' entities for financial reporting purposes.

It is essential that customer-owned banking institutions' financials remain comparable on a like-for-like basis with their investor-owned peers. The NFP framework is unlikely to meet the needs of these users. Customer-owned institutions are regulated by the same regulators (ASIC & APRA) as the broader financial sector. Our sector also raises funds through debt markets, with larger institutions having credit ratings from the major credit rating agencies. Similarly, recent amendments to APRA's regulatory framework will improve our ability to issue equity which is likely to increase our sector's interaction with capital markets.

Ensuring the customer-owned banking sector can continue to use FP standards

COBA believes that our sector must retain the ability to continue to use FP standards. As noted, it is unlikely that financial reports based on NFP standards will meet the broader user needs of our report users (regulators, analysts, investors etc.). COBA believes that the following changes should be made to clarify the FP status of our sector financial reporting purposes.

Broadening the definition to cover FP companies with a different principal purpose

The current concise definition of FPs based on a singular principal 'generation of profit' objective is too simplistic. Modern companies now have multiple objectives and the 'generation of profit' may not be the principal objective for many for-profit companies.

The FP and NFP definitions should be broadened to capture the great diversity in companies that either want to use, or must use, the FP accounting standards. In line with this, COBA suggests that the singular objective test be changed to a multiple objectives test.

Example of a multiple objectives test

For-profit (FP) entities are those entities whose primary objective/s includes the generation of profit.

Not-for-profit (NFP) entities are those entities whose primary objective/s do not include the generation of profit.

This would ensure that customer-owned banks to prescribe both the provision of services to members and the generation of profits as primary goals and still be subject to the FP accounting framework that meets the needs of the broader financial sector. Investor-owned companies could prescribe a single primary profit objective while NFP entities would not prescribe profit as a primary objective.

This more flexible approach allows other customer-owned cooperatives to determine whether they should fit into the FP or NFP frameworks. This is critical given the diversity in the cooperative sector. The cooperative sector ranges from commercially-orientated cooperatives like credit unions or mutual banks to NFP non-distributing cooperatives such as child care cooperatives.

Providing further guidance to clarify entities' FP or NFP status

COBA believes that further guidance is required to assist entities to determine FP/NFP status. This would help to clarify that customer-owned banking institutions are FPs as they provide services at market prices, aim to produce sustainable (i.e. commercial but not excessive) rates of return, pay financial returns on contributed resources (i.e. deposits and borrowing) and do not fund themselves via donations—characteristics that are generally not seen in NFPs.

COBA notes that the New Zealand standards define FPs as entities that are not a public benefit entity (PBE). While this 'negative' test differs from the AASB and COBA proposed

definitions, the NZ definition of PBE includes criteria that may be relevant for any Australian guidance.

New Zealand's XRB A1 Application of the Accounting Standards Framework outlines the following criteria to assist entities to determine whether they are a PBE:

- type of founding document objectives
- nature of the benefits (i.e. whether good and services are provided at market prices)
- quantum of expected financial surplus (i.e. seeking a commercial rate of return)
- nature of equity interest (i.e. whether there are clear equity interests)
- nature of funding (i.e. through sales or donations)

COBA also notes that more detailed NFP definitions in some other countries make it significantly easier to determine whether an entity is not an NFP. Part of these definitions could be included in any proposed guidance on NFPs. For example:

Canada: A *not-for-profit organization (NFPO)*: An entity that is:
(a) normally without transferable ownership interests; and
(b) organized and operated exclusively for social, educational, professional, religious, health, charitable or any other not-for-profit purpose.
A not-for-profit organization's members, contributors and other resource providers do not, in such capacity, receive any financial return directly from the organization. ²

New Zealand: *Public benefit entities (PBEs)* are reporting entities 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. ³

United Kingdom: *Public benefit entity*: An entity whose primary objective is to provide goods or services for the general public, community or social benefit and where any equity is provided with a view to supporting the entity's primary objectives rather than with a view to providing a financial return to equity providers, shareholders or members. ⁴

More comprehensive guidance that draws clearer NFP boundaries using some of the aforementioned criteria or definitions will remove ambiguity about FP/NFP reporting status. Under the above definitions, customer-owned banking institutions are unlikely to meet the above NFP definitions (and therefore implicitly are FPs) due to financial returns paid on contributed resources (e.g. interest on deposits and borrowings) and the 'private' rather than 'public' nature of the benefits provided to our members (i.e. home loans or deposits only benefit the individual customer).

COBA thanks the AASB for the opportunity to comment on this proposal. Please contact Mark Nguyen at mnguyen@coba.asn.au or 02 8035 8443 if you need any further information.

Yours sincerely,



MICHAEL LAWRENCE
Chief Executive Officer

² Guide to Accounting Standards for Not-for-Profit Organizations in Canada: Sep 2012, page 8

³ External Reporting Board Standard A1 Application of the Accounting Standards Framework: Dec 2015, page 6

⁴ Financial Reporting Council: FRS 100 Application of Financial Reporting Requirements: Sep 2015, page 25