



<b>Project:</b>	<b>Not-for-Profit Entity Definition and Guidance</b>	<b>Meeting:</b>	AASB March 2020 (M174)
<b>Topic:</b>	<b>Staff analysis and recommendations on certain responses to ED 291</b>	<b>Agenda Item:</b>	13.1
		<b>Date</b>	19 February 2020
<b>Contact(s):</b>	Ao Li ali@aasb.gov.au 03 9617 7652  Fridrich Housa fhousa@aasb.gov.au 03 9617 7618	<b>Project Priority:</b>	High
		<b>Decision-Making:</b>	High
		<b>Project Status:</b>	Consider specific comments on ED and determine next steps

**OBJECTIVE OF THIS PAPER**

- 1 The objective of this agenda item is for the Board to:
  - (a) **decide** on how to address the key issue of the interaction of the proposed not-for-profit (NFP) entity definition in Exposure Draft 291 *Not-for-Profit Definition and Guidance* (ED 291) with other existing definitions (such as ACNC, ATO and GFS manual); and
  - (b) **decide** on the next steps on how to progress with the proposals in ED 291.

**REASONS FOR THE BOARD TO CONSIDER THIS PAPER AT THIS MEETING**

- 2 Staff presented a summary of the feedback received on the ED 291 at the November 2019 meeting. Subsequently, staff have performed further review and analysis of the comments including further consultations.
- 3 Staff have identified fourteen issues and a number of editorial comments raised by the sixteen respondents to ED 291 (see attachment [M173 Staff Paper 3.1](#)).
- 4 This paper focuses on the most important issue identified, that is, *Interaction of the proposed definition of NFP entity for financial reporting with already established concepts of NFP entity* ([Key Matter 1 in M173 Staff Paper 3.1](#)), given the pervasive nature of the matter and its impact on the direction of the project including conducting a Regulatory Impact Assessment and on other related matters raised by respondents. Four other related issues, as outlined below, are also covered in the discussion of this paper:
  - [Issue 3–SMC1](#): *Cost to implement the proposed definition exceeding its benefit* ([Table 2](#))
  - [Issue 5–SMC1](#): *Further guidance and clarification needed for co-operative, mutual and membership-based entities* (See [Options 3-6](#) in [Table 2](#))

- [Issue 6–SMC2](#): *Classification of entities only carrying out commercial activities and distributing gains to other NFPs or reinvesting the surplus for community or social benefit* (See [Option 5](#) in [Table 2](#))
  - [GMC 8](#): *Appropriate application of NFP Standard-Setting Framework* (see analysis for the existing definition in [Option 5](#) in [Table 2](#))
- 5 This paper does not cover the following issues that staff identified in the Staff Paper 3.1 for the November AASB meeting (extracted in [Appendix C](#)). Subject to the Board decision on the matter identified in paragraph 4 above, staff will subsequently perform further analysis and make recommendations for these issues and bring them to future Board meeting(s):
- [Issue 2–SMC1](#): *Suitability of “equity” concept for some NFP entities*
  - [Issue 4–SMC1](#): *Further clarification/guidance needed for key indicators, including ‘primary objective’, ‘community or social benefit’, ‘goods and services’ and ‘equity holder’*
  - [Issue 7–SMC2](#): *Weighting of multiple indicators in determining the classification*
  - [Issue 8–SMC2](#): *Suitability of implementation guidance and illustrative example for the public sector entities*
  - [Issue 9–SMC3](#): *Impact of classification of controlling entity on the classification of the group*
  - [Issue 10–SMC4](#): *Effective date of the proposals to be aligned with NFP reporting framework and interaction with proposals in ED 297*
  - [Issue 11–SMC4](#): *More guidance on differences in Australian accounting standards requirements for FP and NFP*
  - [Issue 12–SMC4](#): *Disclosure of the reasons for the classification as NFP/FP in the basis of preparation*
  - [Issue 13–SMC5](#): *Transitional relief*
  - [Issue 14–SMC7](#): *Inconclusive implementation guidance*

## ATTACHMENTS

- 6 Staff have included the following attachments for the Board’s reference:
- 13.2 Legal advice – *Not-for-profit meaning at common law and interpretation* [included in the supplementary folder]
  - 13.3 Agenda Paper 3.1 (M173) *Staff paper: Initial summary responses to ED 291* [included in the supplementary folder]

## SUMMARY OF STAFF RECOMMENDATIONS

- 7 Based on the analysis further below, staff recommend that the Board proceed with the proposed new NFP definition and implementation guidance in ED 291 except with the following statement amending implementation guidance ([Option 5 in Table 2](#) further below):
- (a) an entity is an NFP for financial reporting if it is NFP for taxation purposes, unless:
    - (i) its primary purpose is for the financial benefit of its equity holder(s).

## STRUCTURE

- 8 This Staff Paper is set out as follows:
- (a) Background (par. 9-17)

- (b) Options on how to proceed, staff recommendations and questions for the Board (par. 18-21)
- (c) Next steps (par. 22)
- (d) [Appendix A](#): Summary of main differences between Australian Accounting Standards requirements for FP and NFP entities
- (e) [Appendix B](#): Relevant cases
- (f) [Appendix C](#): Summary of written responses for each question (extract from Board Paper 3.1 (M173) *Staff paper: Initial summary responses to ED 291*)

## BACKGROUND

- 9 While majority of respondents agreed with the proposed new definition, some were concerned with the proposed guidance creating potential misalignment with the NFP entity concepts applied by the ACNC, the ATO, GFS manual, other regulators (such as state and territory regulators) or common law concepts (see par. 17, [Table 1](#)) provides further detail highlighting the fact that while definitions are relatively aligned, the application practice differs to implementation guidance in ED 291.
- 10 While there will be a number of instances where the outcome of NFP assessment under Australian Accounting Standards (AAS) may appropriately differ to the assessment for other purposes (e.g. tax), staff have identified that the application of established concepts in several court cases regarding ACNC and ATO assessments may cause diverse outcomes of assessment of NFP status for potentially a large number of entities for financial reporting purposes compared to their ACNC or ATO status. Staff consider the main risk arising from the misalignment are:
- potential confusion for preparers, users and regulators if some entities would be classified as FP for financial reporting purposes and NFP for other purposes (and vice versa) given the common understanding of the term “not-for-profit”; and
  - increased (financial) reporting burden and associated cost arising from the application of broadly consistent definitions and different but related guidance/application that may result in unintended and impractical conflicting outcomes and therefore increased assessment and transition costs. With a limited number of circumstances generating differences between ATO and AASB definitions the question arises whether the benefits of a separate assessment resulting in different NFP status for financial reporting and related financial reporting implications would outweigh the cost.
- 11 Staff have summarised some of the key differences in Australian Accounting Standards requirements between FP and NFP entities in [Appendix A](#). The full list of the specific NFP requirements in AAS is available in [AASB Staff Paper: Modifications to Australian Accounting Standards for Not-for-Profit Entities](#) (note that the paper is being updated for recent changes in AAS). The cost and effort associated with any required changes to the accounting policies if the entity would re-assess their status under new NFP definition will depend on individual facts and circumstances (e.g. not all NFP specific requirements would apply to each entity), noting that some of the specific requirements will apply to large population of NFP entities, such as revaluation requirements (specifically to public NFP entities) or impairment requirements (see [Appendix A](#)).
- 12 While the above issue is not likely to have such wide-spread implications for the NFP public sector (noting however specific requirements in GFS outlined in [Table 1](#) below) , it is expected to have significant implications for the NFP private sector (see par. 12 above). As such, it is important that the *Interaction of the proposed definition of NFP entity for financial reporting*

with already established concepts of NFP entity'<sup>1</sup> is addressed before the next steps for the project are determined.

- 13 Timing and interaction with other projects such as the proposals contained in ED 297 and NFP Private Sector Financial Reporting Framework (FRF) project is also critical and linked to the cost of assessment and transition with the obvious risk for some entities potentially needing to change their accounting policies multiple times over a relatively short period. Changes to the definition of NFP entity resulting in some current NFP entities being classified as FP entities would also result in those entities no longer being able to prepare SPFS once proposals in ED 297 are effective. Also, if entities currently assessed as FP would re-assess as NFP under ED 291 proposals, if these entities transitioned to GPFS under ED 297, they may not be required to prepare GPFS subject to future Board decisions on revised tiers for NFP private sector. As a result, it is important to ensure that revised NFP definition is at minimum available for early adoption by the time: (a) proposals in [AASB Exposure Draft ED 297 Removal of Special Purpose Financial Statements for Certain For-Profit Private Sector Entities](#) are effective and (b) NFP Private Sector FRF project is finalised.
- 14 In addition, staff have also considered, in the absence of a positive definition of NFP entities other than the negative definition used by regulators and in common law, the potential for NFP entity definition in AAS overreaching to other areas of Australian law.
- 15 Staff obtained legal advice (Agenda Paper 13.2) confirming that *“whilst there is potential for a Court to read delegated legislation into various statutory instruments, more recent decisions indicate that delegated legislation (in forms similar to the Accounting Standards published by the AASB) generally should not be considered out of context or taken into account when considering statutory instruments”* and therefore it should not be generally the case that the definition of the NFP entity for financial reporting will be taken into account when determined NFP status for other legislative purposes or common law cases.
- 16 Due to the potentially pervasive implications on the direction of the project and cross-cutting issues with other projects, staff have brought the analysis of interaction of the proposed definition of NFP entity for financial reporting with already established concepts of NFP entity to this Board meeting.
- 17 When considering options how to respond to respondents’ concern, staff have analysed the implications of the different NFP concepts and guidance from different regulators in [Table 1](#) below.

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<sup>1</sup> AASB staff also consulted with NZASB staff on feedback received when the definition of PBE was firstly developed in 2005 in New Zealand and when the implementation guidance was amended in 2019. Common issues including classification for membership-based entities and trading subsidiaries of NFP parents were also raised by NZ constituents. AASB staff understand that Financial Reporting Standards Board (FRSB) (predecessor of NZASB) did not agree that trading entities controlled by charities should automatically be classified as PBEs and agreed that the tax status of an entity was not necessarily relevant for assessment of NFP status of an entity for financial reporting purposes.

Table 1: Summary of NFP definitions and guidance				
	Definition	Guidance	Impact if adopted for financial reporting	Example of entities impacted if definition & guidance adopted for financial reporting purposes
Current AASB Definition	<i>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 (AASB 102, par. Aus6.1)</i>	N/A	No change (noting there may be instances where the current definition has not been applied appropriately).	No change.
AASB ED 291	<i>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.</i>	Key indicators that aim to focus on substance of an entity's purpose: <ul style="list-style-type: none"> <li>- the stated objectives</li> <li>- the nature of benefits, including the quantum of expected financial benefits</li> <li>- the primary beneficiaries of the benefits</li> <li>- the nature of any equity interest</li> <li>- the purpose and use of assets</li> <li>- the nature of funding</li> </ul>	<ul style="list-style-type: none"> <li>- Potential reclassification from assumed NFP status <b>under current AAS definition</b> to FP status for financial reporting purposes: <ul style="list-style-type: none"> <li>o Entities distributing benefits to members e.g. via provision of subsidised goods or services (e.g. some membership-based entities)</li> <li>o NFPs primarily with financial performance targets (e.g. entities should have been FP under the current definition but may not have applied the definition appropriately due to lack of guidance)</li> <li>o FP subsidiaries controlled by NFP parent and primarily carrying out commercial activities to support parent/related parties' NFP/charitable activities assuming assessed as NFP under current AAS definition following their ATO/ACNC status</li> </ul> </li> <li>- Less likely, potential reclassification from assumed FP status under current AAS definition to NFP for financial reporting purposes: <ul style="list-style-type: none"> <li>o Entities generating surplus for sustainability with an overall NFP purpose</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>- Self-assessed NFP entities for ATO purposes and ACNC registered charities (in accordance with <i>Commissioner of Taxation v World Investments</i><sup>5</sup> (hereafter, Word Investment case) with commercial activities and distributing gains to related parties could assess as FP under ED 291 proposals (Example 2: Bicycle Shop)</li> <li>- Self-assessed NFP entities for ATO purposes (in accordance with <i>Commissioner of Taxation v Co-Operative Bulk Handling Limited</i><sup>7</sup>(hereafter, CBH case)) with performance measures focused on financial performance could assess as FP under ED 291 proposals (Stated objectives, par. 17)</li> <li>- Membership-based entities distributing financial benefits to members by ways of provision of discounted/subsidised goods/services could assess as FP under ED 291 proposals (Nature of benefits, par. 24 and Primary beneficiaries, par. 28)</li> </ul>
ATO	<i>An organisation is non-profit if it is not carried on for the profit or gain of its individual members. This applies for direct and indirect gains, both</i>	- ATO would accept an entity as NFP "...if its constitution or governing documents prohibit distribution of profits or gains to individual members and its actions are consistent with the prohibition." <sup>3,4</sup>	- If compared to current AAS definition, likely no significant change, however, some entities may not be applying current AAS definition appropriately	- Likely no significant change compared to current status quo as entities are assumed to follow their ATO status even though in some cases this may result in inappropriate

<sup>3</sup> Refer to the case *Repromed Pty Ltd v. Lucas and Anor (2000) 76 SASR 575*. See [TR 2011/04](#), par. 237-244 for detail.

<sup>4</sup> <https://www.ato.gov.au/Non-profit/Getting-started/In-detail/Types-of-DGRs/DGR-table/?page=14>

Table 1: Summary of NFP definitions and guidance				
	Definition	Guidance	Impact if adopted for financial reporting	Example of entities impacted if definition & guidance adopted for financial reporting purposes
	while the organisation is being carried on and on its winding up. <sup>2</sup>	<ul style="list-style-type: none"> <li>- “an institution could be charitable even where it did not engage in charitable activities itself but instead made profits that were directed to charitable institutions which did engage in charitable activities” (TR 2011/04, par. 242)<sup>5</sup></li> <li>- Entity is “income tax exempted for income derived by a non-profit society or association which has been established primarily for the purpose of promoting the development of aviation, agricultural, pastoral, horticultural, viticultural manufacturing or industrial resources of Australia<sup>6</sup>. Such non-profit purpose is established if any incidental gain or benefit which may be received by members is not received by virtue of the membership but only in common with the broader community.”<sup>7</sup></li> <li>- “organisations carried on for the joint or common benefit of their members can qualify as not-for-profit companies. An example would be a professional association established to advance the professional interests of its members. However, the association must not be carried on for the profit or gain of its individual members.”<sup>8</sup></li> </ul>	<ul style="list-style-type: none"> <li>- Potentially larger number of NFPs if ATO guidance adopted for financial reporting purposes <b>comparing with the proposed definition and guidance in ED 291</b> (assuming following currently self-assessed as NFPs under current AAS definition): <ul style="list-style-type: none"> <li>o Entities with legal form/constitution documents or established by statute preventing distribution of gains to members without providing benefits to community as their primary purpose</li> <li>o Some entities assessed as charitable while not engaging in charitable activities itself but generating and directing benefits to related parties being charitable institutions</li> <li>o Membership-based entities with non-distribution clause providing financial benefits to members (e.g. via provision of subsidised goods and services)</li> </ul> </li> <li>- Some NFP in substance entities (i.e. meeting current and proposed NFP definition under AAS) potentially reclassify to FP: <ul style="list-style-type: none"> <li>o Entities without non-distribution clause in constitutional documents or without legal form/statute preventing distribution of gains to members</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>- application of current NFP definition in AAS, such as: <ul style="list-style-type: none"> <li>o Self-assessed NFP entities for ATO purposes and ACNC registered charities in accordance with Word Investment case</li> <li>o Some membership-based entities with primary focus on generating surplus for members (with non-distribution clause/legal form/statute)</li> </ul> </li> <li>- Entities generating surplus for community benefit without practice of distributing to equity holders without non-distribution clause/legal form/statute (such as those subject to <i>Repromed</i> case<sup>3</sup>)</li> </ul>
ACNC	“...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	<ul style="list-style-type: none"> <li>- Charity means an entity: <ul style="list-style-type: none"> <li>(a) that is a not-for-profit entity; and</li> <li>(b) all of the purposes of which are <ul style="list-style-type: none"> <li>(i) charitable purposes that are for the public benefit</li> </ul> </li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>- If limited to NFP guidance (noting that ACNC currently regulates charities being subset of NFPs), similar to the impact of adopting ATO definition and guidance outlined above as staff have not identified significant differences in the</li> </ul>	<ul style="list-style-type: none"> <li>- Similar to the examples of entities described above if ATO definition &amp; guidance adopted</li> </ul>

<sup>2</sup> <https://www.ato.gov.au/Non-profit/Your-organisation/In-detail/Income-tax/Mutuality-and-taxable-income/?page=2>

<sup>5</sup> Refer to the case *Commissioner of Taxation of the Commonwealth of Australia v Word Investments Ltd* [2008] HCA 55. See TR 2011/04, par. 273-277 or <http://www8.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/HCA/2008/55.html> for detail.

<sup>6</sup> Income Tax Assessment Act, par. 23(h)

<sup>7</sup> Refer to the case *Commissioner of Taxation of the Commonwealth of Australia v Co-operative Bulk Handling Limited* [2010] FCAFC 155. See [Decision impact statement- Federal Commissioner of Taxation Co-Operative Bulk Handling Ltd](#) for detail.

<sup>8</sup> <https://www.ato.gov.au/Non-profit/Your-organisation/In-detail/Income-tax/Mutuality-and-taxable-income/?page=4>

Table 1: Summary of NFP definitions and guidance				
	Definition	Guidance	Impact if adopted for financial reporting	Example of entities impacted if definition & guidance adopted for financial reporting purposes
	<i>people who run it or their friends or relatives)."</i>	<p>(ii) purposes that are incidental or ancillary to, and in furtherance or in aid of, purposes of the entity covered by subparagraph</p> <p>(Part 2, Division 1, par. 5, <a href="#">Charities Act 2013</a>)</p> <p>- an entity can be a NFP <i>"if it simply provides a benefit to a member while genuinely carrying out its purpose. For example, organisations such as self-help groups can be not-for-profits if the benefits provided to members are consistent with the purposes of the organisation."</i><sup>9</sup></p>	outcome of the NFP assessment between ATO and ACNC. <sup>10</sup>	
GFS	Non-profit institutions (NPIs) are defined in the SESCA <sup>11</sup> as legal or social entities created for the purpose of producing goods and services whose status does not permit them to be a source of income, profit or other financial gain for the units that establish, control or finance them ( <a href="#">5514.0 Australian System of Government Financial Statistics: Concepts, Sources and Methods 2015</a> , par. 2.43)	- <i>"... non-profit institution must have an enabling instrument which includes a clause that prohibits the NPI from distributing income, profit or other financial gain to its establishing, controlling or financing unit ..."</i> ( <a href="#">5514.0 Australian System of Government Financial Statistics: Concepts, Sources and Methods 2015</a> , par. 2.43).	<p>- Some NFP in substance entities (i.e. meeting current and proposed NFP definition under AAS) potentially reclassify to FP:</p> <ul style="list-style-type: none"> <li>o Entities without enabling instrument preventing distribution of gains to its establishing, controlling or financing unit</li> </ul> <p>- Potentially some entities generating but not maximising surplus (i.e. less than commercial or market surplus) currently assessed as public sector FPs could assess as NFP depending on individual circumstances.</p>	- Entities without enabling instrument preventing distribution of profits would be classified as FP for financial reporting purposes

<sup>9</sup> <https://www.acnc.gov.au/for-charities/start-charity/not-profit>

<sup>10</sup> Likewise, e.g. section 4 of Associations Incorporation Reform Act 2012 in Victoria allows the members of an association to receive benefits without considering association to be securing pecuniary profit.

<sup>11</sup> Standard Economic Sector Classification of Australia

## OPTIONS ON HOW TO PROCEED, STAFF RECOMMENDATIONS AND QUESTIONS FOR THE BOARD

18 Based on the analysis of the interactions of respective definitions & guidance in [Table 1](#) above staff summarised options how to proceed with advantages and disadvantages for each in the table below followed by staff recommendation and questions to the Board.

Table 2: Options on how to proceed		
Options considered by Staff	Advantages	Disadvantages
1. Maintain the existing definition and do not proceed with the ED	<ul style="list-style-type: none"> <li>No implementation effort required and no associated cost incurred.</li> </ul>	<ul style="list-style-type: none"> <li>Respondents to <a href="#">ITC 37 The AASB's Standard-Setting Frameworks for For-Profit Entities and Not-for-Profit Entities</a> indicated the current negative statement of NFP definition is problematic;</li> <li>current definition is centred negatively as 'an entity whose principal objective is not the generation of profit';</li> <li>lack of guidance how to apply current definition; and</li> <li>existing divergence in NFP definition for financial reporting purposes and concepts used by other regulators likely resulting in NFP definition under AAS applied incorrectly in some cases.</li> </ul>
2. Proceed with the proposed definition and implementation guidance	<ul style="list-style-type: none"> <li>The existing definition, which is centred negatively is replaced by a new constructive one accompanied with appropriate application guidance;</li> <li>Classification of entities for financial reporting purposes will be on substance-over-form basis, which allow entities to apply most appropriate accounting treatments fitting for their nature.</li> </ul>	<ul style="list-style-type: none"> <li>Potential misalignment between NFP definition and its application in AAS and other concepts, including ATO and ACNC;</li> <li>Likely to increase the number of FP entities for financial reporting purposes and considerable assessment cost as potentially large number of entities (i.e. at least majority of approx. 137,000 self-assessed NFP tax exempt entities) being membership based entities would need to spend time and effort on assessment and possibly change their classification and accounting policy accordingly.</li> </ul>
3. Adopt ACNC and/or ATO NFP definition and application practice for financial reporting purposes	<ul style="list-style-type: none"> <li>Same as Option 1 (no implementation effort required, and no associated cost incurred on assumption that entities currently self-assessed in line with their ATO/ACNC classification);</li> <li>Reduced divergence in NFP definition for financial reporting purposes and concepts used by other regulators.</li> </ul>	<ul style="list-style-type: none"> <li>Form-over-substance assessment for entities classification: <ul style="list-style-type: none"> <li>NFP in substance but not accepted as NFP due to absence of non-distribution clause in constitution documents would not be classified as NFP for financial reporting purpose. Preparation cost would likely increase for these entities to comply with FP financial reporting framework.</li> <li>Entities set up with the objective to generate profit and distributing via other means than distributing surplus (e.g. donations to related parties) with the non-distribution clause in their founding documents or legal form/statute would be classified as NFP for reporting purpose and apply NFP reporting framework, which can lead to inappropriate accounting treatment and misleading information for users' decision making.</li> </ul> </li> <li>The ATO/ACNC application guidance may not be applicable for NFP public sector entities.</li> <li>Inappropriate accounting reporting for subsidiaries primarily carrying out commercial activities (FP in substance but applying NFP reporting</li> </ul>

Table 2: Options on how to proceed		
Options considered by Staff	Advantages	Disadvantages
		<p>framework following their ATO/ACNC status) and reporting not consistent with nature of the entity.</p> <ul style="list-style-type: none"> <li>• <a href="#">ACNC guidance for NFP</a> and <a href="#">ATO guidance for NFP entities for taxation purpose</a> are negative statements with same issue as in Option 1.</li> <li>• Terms used in ATO/ACNC definition and application guidance use of certain term (e.g. “gains”) is not necessarily aligned with AAS and may lead to confusion.</li> <li>• ACNC and ATO do not have a single generally accepted definition (other than common negative statement similar to current AAS definition) for NFP but rather guidance for difference scenarios, which deviates from the principle-based standard-setting approach.</li> <li>• AAS may need to be amended subsequently when there are any future changes in ACNC/ATO guidance.</li> </ul>
<p>4. Proceed with the proposed new NFP definition and implementation guidance in ED 291 (Option 2) except for amending implementation guidance with the statement:</p> <p>(i) an entity is a NFP for financial reporting purposes if an entity’s legal form/statute or constitution prohibits it from distributing profit or surplus</p>	<ul style="list-style-type: none"> <li>• Advantages of the proposed definition accompanied with appropriate application guidance retained (same as Option 2)</li> <li>• Reduced divergence in NFP definition for financial reporting purposes and concepts used by other regulators, including public sector</li> <li>• Reduced transition cost (compared to Option 2) as the entities potentially needing to change from NFP to FP for reporting purposes, particularly for those resource and time poor, such as membership-based clubs and incorporated associations carrying activities not primarily for the benefit of community and social benefits would remain as NFP entities (and aligned with assessment for taxation purposes).</li> </ul>	<ul style="list-style-type: none"> <li>• Same as the first 3 dot-points in Option 3</li> </ul>
<p>5. Proceed with the proposed new NFP definition and implementation guidance in ED 291 (Option 2) except for amending implementation guidance with the statement:</p> <p>(i) an entity is a NFP for financial reporting purposes if an NFP for taxation purpose, unless:</p> <p>(a) its primary purpose is for the financial benefit of its equity holder(s)</p>	<ul style="list-style-type: none"> <li>• Same as Option 4, and in addition, entities like membership-based entities and co-operatives with principal objective to generate profit (or maximise financial benefits e.g. via provision of discounted goods and services, subsidised prices or rebates) will apply appropriate accounting treatment for their FP nature (regardless whether their legal form or non-distribution clause in the constitutional documents prohibits distribution of the surplus), which is consistent with the substance-over-form assessment.</li> <li>• FP subsidiaries of NFP parent will apply appropriate accounting treatment aligned with the substance of their operations.</li> <li>• Alignment with GFS requirements maintained, as public sector entities with non-distribution instrument likely to assess as NFP.</li> <li>• Appropriate application of <a href="#">The AASB’s Not-for-Profit Entity Standard-Setting Framework</a>, specifically par. 23 referencing need to consider “(ii) Australian-specific legislation” and “(v) under cost or effort considerations”. Paragraph 4.1 of the <a href="#">AASB Due Process Framework</a></li> </ul>	<ul style="list-style-type: none"> <li>• Same as Option 4, in addition:</li> <li>• Transition cost incurred by limited number of entities that may potentially need to change accounting policies (if currently self-assessed as NFPs) and resulting need to perform (limited) consolidation adjustments when consolidating into the NFP group financial statements, such as FP subsidiaries and membership-based entities primarily operate to generate financial benefits to members. Staff noted that these entities would be likely assessed as FP under the existing definition in AAS (see par. 25 in <a href="#">Appendix A</a> below).</li> </ul> <p>(Based on 2017 ACNC AIS data, 1,272 (out of 15,004) individual charities and charity groups report consolidated with more than one entity noting that majority of these would not contain trading subsidiary that would not satisfy NFP definition, so the number of impact entity that potentially may need to transition would likely be substantially lower.)</p>

Table 2: Options on how to proceed		
Options considered by Staff	Advantages	Disadvantages
	<p><a href="#">for Setting Standards</a> specifically makes reference to the effort to “avoid creating cumulative or overlapping regulatory burdens”. Given the small size of many of membership-based entities and resulting time and resource constraints, preparation two sets of financial reports on different basis for financial reporting and for taxation/charitable purposes as requested by specific regulators would represent undue burden.</p> <ul style="list-style-type: none"> <li>• Easier assessment process for entities currently assessed as NFP with clear link to existing self-assessment for taxation purposes without need to weight multiple indicators (e.g. stated objectives, primary beneficiaries and nature and quantum of the benefits that membership based entities would likely need to assess).</li> <li>• Number of impacted entities relatively limited (ACNC indicated that about 300 registered charities would change classification from NFP to FP under the proposed new definition). Staff did not assess NFP entities reporting to state regulators due to lack of data and time available but expect the impact to be limited.</li> </ul>	<ul style="list-style-type: none"> <li>• Potential arbitrage and inconsistency arising from the specific treatment of particular type of the entities (such as “FP subsidiary to generate profits for NFP parent”).</li> <li>• Entities without the distribution prohibition clause (or respective legal form/statute) could still meet the base NFP definition, which could be a different outcome to ATO and ACNC (but aligned with the substance-over-form approach).</li> <li>• Need to monitor any ATO NFP definition &amp; guidance changes on on-going basis to assess impact on financial reporting.</li> </ul>
<p>6. Proceed with the proposed with the proposed new NFP definition and implementation guidance in ED 291 (Option 2) except for amending implementation guidance with the statement:</p> <p>(i) an entity is a NFP for financial reporting purposes if an NFP for taxation purpose, unless:</p> <p>(a) its primary purpose is for the financial benefit of its equity holder(s)</p> <p>(b) it voluntarily elects to be a FP entity</p> <p>(Note that FP election can be considered for all options listed in this table)</p>	<ul style="list-style-type: none"> <li>• Same as Option 5, and</li> <li>• Voluntary adoption of the FP reporting framework would meet the needs of some entities (e.g. mutuals and co-operatives), who aim to comply with IFRS but might otherwise meet the NFP definition.</li> </ul>	<ul style="list-style-type: none"> <li>• Same as option 5, and</li> <li>• Diversity in practice across entities in NFP sector in application of the specific NFP requirements in AAS;</li> <li>• Potential risk that user needs and specific NFP issues were not addressed if NFP entity in nature elects to assess as FP entity and apply AAS requirements for FP entities.</li> </ul>

## Staff Recommendation

- 19 Based on analysis above, staff recommend [Option 5](#) to proceed with the proposed new NFP definition and implementation guidance in ED 291 except implementation guidance states:
- (a) an entity is an NFP for financial reporting if it is NFP for taxation purposes, unless:
    - (i) its primary purpose is for the financial benefit of its equity holder(s).
- 20 This option addresses the issues that the existing negative definition has, reduces divergence between NFP definition for financial reporting and taxation/charitable purposes, is likely to have relatively lower transition cost than Option 2 (being important consideration for NFP sector) and adopts substance-over-form approach for the key entities that should be applying FP reporting requirements to the activities carried out to achieve the purpose of that entity. Entities primarily carrying out activities to earn profits for sustainability of a NFP parent or primarily generating benefits to distribute to equity holders other than by way of dividend would account appropriately to determine those profits. This option more appropriately balances the costs to preparers with the benefits of the appropriate financial reporting outcomes to be consistent with the primary purpose of the entities.
- 21 For all the options listed in [Table 2](#) above, staff considered the available option to adopt FP reporting framework voluntarily. While this option may remove concerns that some entities assessed as NFPs may not be able to comply with IFRS, consideration needs to be given to the on-going relevance of *The AASB's Not-for-Profit Entity Standard-Setting Framework* outlining cases when NFP modification (being departure from IFRS) is justified, such as user needs and NFP issues not appropriately dealt with in existing IFRS Standards.

## QUESTIONS FOR THE BOARD

**Q1.** Does the Board agree with the staff recommendation to proceed with the project?

**Q2.** Does the Board agree with the option recommended by the staff and if not, does the Board prefer any other option presented and are there other options staff should consider?

**Q3.** Would the Board agree to provide an election to assess as FP entity to enable reporting under FP requirements of AAS?

## NEXT STEPS

- 22 Subject to the Board decisions at March 2020 meeting on the overall direction of the project, staff will finalise analysis and recommendations on the other matters identified as outlined [Appendix C](#) and will bring to the Board at its April and June meetings including consideration whether the proposals need to be re-exposed in line with AASB Due Process guidelines. This is based on the assumption that Board agrees with staff recommendation to defer the effective date of proposals contained in AASB Exposure Draft ED 295 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* and ED 297 to periods beginning on or after 1 July 2021.

## QUESTIONS FOR THE BOARD

**Q4.** Does the Board agree with the suggested next steps and their timing?

## APPENDIX A: SUMMARY OF MAIN DIFFERENCES BETWEEN AUSTRALIAN ACCOUNTING STANDARDS REQUIREMENTS FOR FP AND NFP ENTITIES

- 23 The classification of an entity as a FP entity or a NFP entity is important because the application of the AAS can differ depending on whether an entity is classified as a FP or NFP entity. Different recognition, measurement, presentation and disclosure requirements can apply to an entity depending on whether it is a FP or NFP entity, for example:
- (a) the differences for recognition and measurement of property, plant and equipment for FP and NFP entities as per AASB 116 *Property, Plant and Equipment*. For recognition, FP entities applies the revaluation model on individual asset basis (AASB 116, paragraphs 39 & 40), whereas for NFP entities, net increase/decrease raised from revaluation shall be recognised on a class of asset basis (AASB 116, paragraphs Aus39.1 & Aus40.1-Aus40.2).
  - (b) for measurement, all item of property, plant and equipment for FP entities that qualifies for recognition as an asset shall be measured at it cost (AASB 116, paragraph 15). In respect of not-for-profit entities, notwithstanding paragraph 15 in AASB 116, where an asset is acquired at no cost, or for a nominal cost, the cost is its fair value as at the date of acquisition.
  - (c) in accordance with par. Aus5.1 of AASB 136 *Impairment of Assets*, many assets of NFP entities that are not held primarily for their ability to generate net cash inflows are typically specialised assets held for continuing use of their service potential. The recoverable amount of such assets is expected to be materially the same as fair value, determined under AASB 13 *Fair Value Measurement*, particularly for assets accounted for under the cost model in AASB 116 and AASB 138. This is naturally not available for FP entities.
  - (d) reversal of an impairment loss on a revalued asset for NFP entities is recognised in other comprehensive income and increases the revaluation surplus on the same class of asset, whereas for FP entities, the reversal needs to be recognised in other comprehensive income and increases the revaluation surplus for that asset (AASB 136, par. 120 and Aus120.1).
- 24 Differences in AAS for NFP and FP entities is important consideration for assessment of transition and on-going cost in respect of proposed definition for entities assessment on stand-alone basis and separately for consolidation purposes. On stand-alone basis, while there are differences between FP and NFP, the assessment and transition cost are not expected to be onerous at an entity level and number and type of entities that are likely to transition (and therefore complexity of assessment and potential accounting policy changes) depends on the option selected.
- 25 Consolidation adjustments may be needed when consolidating FP subsidiary into NFP group, however, for example impairment assessment of cash-generating assets performed at FP subsidiary entity-level would not necessarily be reversed when the assets are consolidated into NFP group. This is consistent with guidance for mixed groups provided in Appendix B of New Zealand [PBE IPSAS 6 Consolidated and Separate Financial Statements](#) (par. B11 in particular). When a group controls both FP and NFP entities with for cash-generating and non-cash-generating respectively, although the physical nature of the assets is similar, restatement is not required in the consolidated financial statement because of the different use of the services embodied in the asset.

## APPENDIX B: RELEVANT CASES

### **Non-distribution clause in constitution documents**

*(Repromed Pty Ltd v. Lucas and Anor (2000) 76 SASR 575)*

- 26 Based on the outreach, staff understand that, for simplicity, whether an entity is a NFP entity for taxation purposes depends on whether entities have the non-distribution clause in the constitution document/governing document based on the common law case, *Repromed Pty Ltd v. Lucas and Anor (2000) 76 SASR 575*. In this case, the court ruled that an entity would not be NFP for taxation purpose if there is no non-distribution restriction in its constitution documents regardless of its objective (whether to primarily to provide community and social benefit rather than generate financial profits to return to equity holder).
- 27 In the decision of the Supreme Court of South Australia in *Repromed Pty Ltd*, the court concluded that an employer could not satisfy the requirement that it provide health services other than for the purpose of profit or gain if its constituent documents did not provide that profits could not find their way into pockets of individuals. *Repromed Pty Ltd's* constitution documents did not contain this constraint, so it could not satisfy this requirement (paragraph 237-238, Tax Ruling 2011/4). In theory, in the absence of the non-distribution restriction in the constitution documents, an entity is able to distribute financial returns to its members, even though it has never done so in the past. Circumstances may change over time and not distributing financial returns/surplus in the past does not mean the entity would not do so in the future.
- 28 Staff understand that ATO refers to *Repromed* case when determining whether an entity is NFP for taxation purpose or not. TR 2011/04 paragraphs 239-240 states that following the decision in *Repromed*, “the constituent documents of a charitable institution should in most cases include appropriate clauses to constrain private profit.... In limited circumstances, it may be accepted that an institution is not for private profit even if its constituent documents do not contain non-distribution clauses. Examples are where a corporation is formed by statute and its provisions make the not for profit nature clear, or where a trust is established by deed or will providing that the property can be used for charitable purposes only.” Therefore, staff understand that for taxation purpose, an entity need to have an explicitly stated non-distribution clause in its constitution document to be a NFP or the entity is funded by statute which prevent it from distributing incomes to members of entity.
- 29 This however also means that the differences in implementation guidance from AASB and ATO/ACNC could lead to one entity having different classification for different purposes. For example, an entity meets the criteria to be a NFP for financial reporting purposes without non-distribution clause in its constitution documents, based on *Repromed*, this entity would not be recognised as a NFP for taxation purpose.

### **Charities carry out commercial activities generating financial benefits distributed to related parties**

*(Commissioner of Taxation of the Commonwealth of Australia v Word Investments Ltd [2008] HCA 55)*

- 30 Staff noted concerns from constituents that registered charities could potentially be classified as FP under the proposed new definition in relation to subsidiaries of charities that carry out commercial operations (Illustrative Example 2 of the bicycle shop in ED 291). Staff understands that ACNC's and ATO's classification is based on court ruling in the case of *Word Investments* as discussed in [Table 1](#) earlier.

31 Paragraph 242 of the TR 2011/04 states that “...distributions of profits (or the potential for distributions of profits) from a commercial activity to owners or members will not always result in a private benefit to the owner or member. In *Word Investments* the High Court concluded that a company limited by guarantee that gave its profits to a Christian missionary organisation and other similar organisations was a charitable institution. The recipients were not actually members of the company but were closely related. The High Court held that an institution could be charitable even where it did not engage in charitable activities itself but instead made profits that were directed to charitable institutions which did engage in charitable activities. It said that no distinction should be drawn between a company limited by guarantee with charitable objects that operated two divisions to effect its charitable purpose, and a company limited by guarantee that had the same objects and made the same profits as the first but gave those profits to other organisations which spent them on those objects.”

32 Further, paragraph 243 states that “on the basis of the decision in *Word Investments*, critical questions in circumstances similar to those considered in that case are whether the institution has charitable as opposed to purely commercial objects, and whether the application or distribution of profits is in furtherance of those charitable objects. The fact that the recipient could be an owner or member of the institution does not alter the characterisation of the institution as long as:

- the sole purpose of the institution making the distribution is charitable;
- its constituent documents allow it to distribute its surplus or profit to another entity or entities in order to effect that sole charitable purpose; and
- its constituent documents restrict potential recipients of the surplus or profit to charitable entities that have a similar charitable purpose as the institution itself.

*In these circumstances, the Commissioner will accept that the distribution of profit is not for the private benefit of the members or owners but for the benefit of the public generally.”*

#### **Benefits to members vs community**

*(e.g. Commissioner of Taxation of the Commonwealth of Australia v Co-operative Bulk Handling Limited [2010] FCAFC 155)*

33 Number of respondents requested further guidance on the consideration of membership-based organisation and on the “nature of benefits” indicator in the implementation guidance ([Issue 5, SMC 1](#)). It is likely that the entities carried out for the benefit of their members solely may not satisfy the first leg of the proposed definition. However, for ATO purposes, “organisations carried on for the joint or common benefit of their members can qualify as not-for-profit companies. An example would be a professional association established to advance the professional interests of its members. However, the association must not be carried on for the profit or gain of its individual members.” This application practice has resulted from number of cases such as *Australian Dental Association (NSW Branch) v. F C of T* (1934) 3 ATD 114 and *Federal Commissioner of Taxation v Co-operative Bulk Handling Ltd* [2010] FCAFC 155 ultimately leading to assessment that entity is not operated for profit unless it is carried for the profits or gains for individual members (as opposed to the joint benefit) or those profits are disbursed to those members.

34 Co-operative Bulk Handling Ltd (CBH) is the major bulk handler of grain in WA and registered charity with ACNC. Based on the information included in the CBH’s 2019 annual report, CBH’s primary objective appears to be “returning surpluses and reducing fees (to its members)” and its

core purpose is to “sustainably create and return value to current and future Western Australian grain growers”<sup>12</sup>, with key metrics such as “group net profit after tax” and “group rebates”.

- 35 In 2008, CBH applied for a private ruling on whether it was exempt from income tax under section 50-40 of the *Income Tax Assessment Act 1997* [equivalent to s 23(h) of the ITAA 1936]. The Commissioner ruled that CBH did not satisfy either the positive or negative limbs of section 50-40 of the Act on the basis that it was not an association established for the purpose of promoting the development of Australian agricultural resources and was carried on for the profit or gain of its members.
- 36 The case was later brought to the Court and the Court “rejected the Commissioner’s submission that the “development of agricultural resources” is confined to the farm side of the “farm gate” and concluded that the term “agricultural resources” has a broader meaning than the word “agriculture”. He held that it would be artificial to distinguish the product of agriculture and the means by which it is handled in bulk from the activities of planting, growing and harvesting inside the “farm gate”... CBH was and continues to be established primarily for the purpose of promoting the development of the grain growing industry of Western Australia and that the current and proposed activities of CBH are evolutionary in character and not static. ...CBH is not carried on for the individual profit or gain of its individual members, as it cannot distribute its assets but must apply them only to the furtherance of its objects. CBH’s members benefit from its activities not because they are members but because they are growers.” (Refer to the ATO published [Decision impact statement](#) for more detail).

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<sup>12</sup> [CBH Annual report 2019](#)

## APPENDIX C: SUMMARY OF WRITTEN RESPONSES FOR EACH QUESTION

**SMC 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.**

Opinion	Agree	Agree with Comments	Disagree	Unclear	No comments	Total
Respondents	<b>4</b> <b>4 Accounting firms</b> (S1-PwC; S2-Pitcher Partners; S10-GT; S11-EY)	<b>7</b> <b>2 Accounting firms</b> (S9-SD; S13-Deloitte) <b>1 Auditor</b> (S8-ACAG) <b>2 Professional bodies</b> (S4-CAANZ&CPA; S6-AICD) <b>1 Preparer</b> (S12-HoTARAC) <b>1 Regulator</b> (S7-ACNC)	<b>5</b> <b>1 Accounting firm</b> (S3-KPMG) <b>1 Auditor</b> (S5-DH) <b>1 Professional body</b> (S14-BCCM) <b>2 Others</b> (S15-LCA; S16-QLS)	-	-	<b>16</b>

### **Issue 1: Potential conflict between the proposed not-for-profit (NFP) entity definition for financial reporting purposes and already established concepts of NFP entity**

Five respondents (S4-CAANZ&CPA, S6-AICD, S7-ACNC, S8-ACAG, S9-SD) were concerned about the potential misalignment between the proposed new definition of NFP entity with the NFP entity concepts applied by either the ACNC or the ATO. This has also been reiterated by some respondents in their feedback on illustrative examples and implementation guidance (see [Issue 6, SMC 2](#)) and in some of the feedback requiring more guidance for membership-based entities (see [Issue 5, SMC 1](#)).

In particular, S4-CAANZ&CPA and S7-ACNC expressed concerns with paragraph 5 of the Appendix B in the ED stating that “... *it is possible for a registered charity to be classified as a FP entity for financial reporting purpose*”. The definition of ‘charity’ set out in the Charities Act 2013 stipulates that “... *charity means an entity: (a) that is a not-for-profit entity...*” and as a result, all charities registered with ACNC, including those that carry out commercial activities but distributing all of its gains/surplus to other NFP entities, (refer to [Issue 6, SMC 2](#)) are considered to be NFP entities. These respondents expressed concerns that a few hundred charities currently registered with the ACNC may have to prepare financial reports under FP framework as a result of the proposals, despite having a charity (and therefore NFP) status under law. Also, S15-LCA commented that the proposed definition is “*narrower than the traditional concept as accepted by the ACNC and ATO*”, for example, “*some charities provide money or benefits to their members as a means of carrying out their charitable purpose*”.

Concerns about potential divergence of the proposed NFP definition with the legal meaning of NFP, as determined by its ordinary meaning and the common law, have also been raised by three respondents who did not agree with the ED’s proposal (S14-BCCM; S15-LCA; S16-QLS). In particular, S14-BCCM requested the Board consider the impact of the proposed definition on common law concepts of mutuality, profit and surplus. This respondent also noted that some co-operative and mutual enterprises (CMEs) were also concerned about their ability to claim compliance with International Financial Reporting Standards (IFRS) if considered as NFP entities under the proposed definition due to modifications introduced by “Aus” paragraphs in Australian Accounting Standards (AAS) applicable to NFP entities.

S16-QLS referred to the article *“The Non-Distribution Constraint and Social Enterprise – Can Share Capital Fund Nonprofit Organisations”* by Andrew Lind (unpublished), which states that *“... the common law meaning of not-for-profit is not-for-private-profit... as long as the profit is applied to the NFP purposes as opposed to private persons...”* and asserts that the private persons excluded from the profits is anyone other than another similar purpose NFP or the ultimate beneficiaries of the NFP purpose. The respondent suggested to adopt alternative definition linked to Commonwealth taxation laws and the regulatory guidance proposed by the ATO from time to time.

S8-ACAG recommended the AASB to consider the relevance of the ABS GFS manual definition for general government units (ABS GFS 2015, paragraph 2.36) and non-profit institutions (ABS GFS Manual 2015, 2.43) and was concerned that *“the current guidance does not address general government units which do not provide goods or services for community or social benefit.”*

### **Summary of Staff recommendations and Questions to the Board**

See Key matter 1 above.

### **Issue 2: Suitability of ‘equity’ concept for some NFP entities**

Six respondents (S8-ACAG, S12-HoTARAC, S13-Deloitte, S14-BCCM, S15-LCA, S16-QLS) are concerned with the use of the term of ‘equity’ in the proposed definition that is not suitable for all not-for-profit entities given the wide variety of structures that feature in this sector.

For example, S13-Deloitte pointed out that *“...in cases of subscription-based or membership-based entities, the members or subscribers are the parties who provide the necessary funds for the operations or the entity via the fees it pays and are the parties who essentially obtain the benefits through the operations of the entity, but in essence, they are not considered to be equity holders as they do not contribute ‘equity’.”* S14-BCCM urged AASB to consider implications of the proposed definition for NFP mutual entities that elect to issue Mutual Capital instruments and may make distributions on these instruments.

Similarly, S12-HoTARAC suggested to replace the term ‘equity’ and ‘equity holders’ with ‘owners’ contribution’ and ‘owners’ respectively, or to add equity and equity holders to the list of defined terms and explicitly define this to include a broad range of arrangements. Minority of S12-HoTARAC also disagreed with the return of the surplus to owners being key leg of the definition as these criterion does not suit well the public sector.

### **Issue 3: Cost to implement the proposed definition exceeding its benefits**

Two respondents (S3-KPMG, S5-DH) commented that the amendment of the current definition may not be needed as there is no evidence suggesting that there are issues with current definition and its application. These respondents were also concerned with the cost required to implement the new definition may exceed the benefits to the users of financial statements. This view has been also adopted by one jurisdiction with divergent view in S8-ACAG submission.

S12-HoTARAC minority also expressed the concerns (see [GMC 8](#)) that the AASB appears to have gone beyond the request of constituents for more guidance concerning determination of NFP status by also altering the definition itself.

### **Issue 4: Further clarification/guidance needed for key indicators, including ‘primary objective’, ‘community or social benefit’, ‘goods and services’ and ‘equity holder’**

One respondent (S3-KPMG) was concerned about the potential difficulties in determining whether the community or social benefit criterion would be met by an entity’s objective, as the assessment could be highly subjective. The respondent recommended additional guidance to minimise the potential diversity that could arise from exercising the significant judgement required for this assessment. Three other respondents (S8-ACAG; S9-SD, S15-LCA) also requested further clarification of the term

'community or social benefit' used in the proposed definition, or to provide clear illustrative example for the term. S15-LCA also requested clarification of terms such 'primary objective', 'goods & services' and 'equity holder' and expressed the concerns that the proposed definition is not unclear as to "whether it only applies to entities which provide goods or services, or whether it can be read to apply to entities which provide social benefit..." For example, a grant-making foundation does not provide 'goods or services' according to the ordinary meaning of those terms. S7-ACNC recommended amendments to the guidance referring to the 'nature of equity interest' and 'purpose and use of assets' to clarify that ACNC registered charity generating a financial benefit solely for other registered charities or philanthropic trusts holding assets mainly for sale or to generate profit in order to make grants to other NFP organisations are NFP entities themselves.

**Issue 5: Further guidance and clarification needed for co-operative, mutual and membership-based entities**

Ten respondents (S4-CAANZ&CPA, S5-DH, S8-ACAG, S9-SD, S10-GT, S11-EY<sup>13</sup>, S13-Deloitte, S14-BCCM, S15-LCA, S16-QLS) requested further guidance on the consideration of membership-based organisation and on the "nature of benefits" indicator in the implementation guidance and illustrative examples. These respondents found the statement in Appendix B, paragraph 28 of the ED "if the primary beneficiaries are members of the entity, it is necessary to consider other factors to determine whether the entity is a NFP entity (for example, the nature of the benefits and other indicators in this guidance" either unclear or confusing and requested further guidance, e.g. whether the benefits refer to the financial surplus generated by the entity or the services provided by the entity.

**SMC 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.**

Opinion	Agree	Agree with Comments	Disagree	Unclear	No comments	Total
Respondents	<b>2</b> <b>2 Accounting firms</b> (S1-PwC <sup>14</sup> ; S2-Pitcher Partners <sup>15</sup> )	<b>10</b> <b>5 Accounting firms</b> (S3-KPMG; S9-SD; S10-GT; S11-EY; 13-Deloitte) <b>1 Auditor</b> (S8-ACAG) <b>2 Professional bodies</b> (S4-CAANZ&CPA; S6-AICD) <b>1 Preparer</b> (S12-HoTARAC) <b>1 Regulator</b> (S7-ACNC)	<b>4</b> <b>1 Auditor</b> (S5-DH) <b>1 Professional body</b> (S14-BCCM) <b>2 Others</b> (S15-LCA; S16-QLS)	-	-	<b>16</b>

<sup>13</sup> S10-GT and S11-EY explicitly agree with the proposed definition in SMC 1 but required further clarification and guidance for membership-based entities in SMC 2.

<sup>14</sup> Response implied/extracted from other section of submission.

<sup>15</sup> Response implied/extracted from other section of submission.

**Issue 6: Classification of entities only carrying out commercial activities and distributing gains to other NFPs or reinvesting the surplus for community or social benefit**

Three respondents (S4-CAANZ&CPA, S7-ACNC, S8-ACAG) expressed concerns with the illustrative example No. 2 (Bicycle shop) and the indication suggesting that entity providing services at market rates with a view to maximise the financial surplus returned to the parent that is a charitable organisation would be considered a FP entity. Similarly, S13-Deloitte was concerned that a private education organisation illustrated in example No. 3 in the ED could be considered as a FP entity despite its primary objective being to provide services for community or social benefits and reinvesting the surplus to support such primary objective.

S16-QLS referred the article by Andrew Lind which stated that *“the current Australian legal meaning of not-for-profit is determined by its ordinary meaning and the common law”*<sup>16</sup>, e.g. [Commissioner of Taxation of the Commonwealth of Australia v Word Investments Limited \[2008\] HCA 55](#). These cases determine that making of profit from trade by a NFP entity is permissible as long as the profit is applied to NFP purposes. In the case of *Word Investments*, an entity which only carried out commercial activities and distributed profits to a charitable religious entity, was ruled by the court to be charitable despite the fact that its only activities were commercial, on the basis that it had solely charitable purposes and donated its profits to another charity.

S7-ACNC also asserted that classification of the bicycle shop in the illustrative example No. 2 as a FP entity is in contrary to the current legal situation in Australia where a business operating to raise funds to solely put toward a charitable purpose, that business has a charitable purpose even if the business itself is not of a charitable nature. ACNC also questioned benefit to the users if a charity reports under a FP reporting framework and whether these benefits outweigh the cost for a charity to prepare such financial statements.

**Issue 7: Weighting of multiple indicators in determining the classification**

S8-ACAG requested guidance to demonstrate how to apply the weighting of the indicators referred to in paragraph 37 of the ED and suggested some indicators (e.g. stated objectives combined with nature of benefits) could have more weighting than others. S9-SD also commented that ‘stated objectives’ and ‘nature of equity’ should be primary indicators because of their objective nature which in turn would assist with the assessment of NFP classifications for members-based organisations or children education providers. S15-LCA commented that the guidance does not provide clear answers and the factors are different to those used in the context of the meaning of ‘not-for-profit’.

S5-DH also asserted that *“having a multitude of indicators, as proposed, likely to cause problems in the future as companies get more into corporate social responsibility and virtue signalling...aim to satisfy a multitude of stakeholders not just shareholders.”* The respondent also did not find the guidance particularly useful as they considered the examples and guidance inconclusive and as such, unlikely to reduce diversity of application.

**Issue 8: Suitability of implementation guidance and illustrative examples for the public sector entities**

S8-ACAG commented that the guidance and examples lack a public sector perspective and may not be sufficient to assist users in the public sector make the appropriate judgements to conclude whether an entity is FP or NFP. This respondent also recommended to consider the definition in light of the proposed concept of ‘service capacity of assets’ in AASB 13 *Fair Value Measurement*, with S12-HoTARAC expressing similar concern if the assets held for service potential are to be reported under FP framework. S12-HoTARAC also raised concerns that the term ‘commercial or market returns’ may not be fit for public sector entities.

<sup>16</sup> Andrew Lind, “The Non-distribution Constraint and Social Enterprise – Can Share Capital Fund Nonprofit Organisations” (unpublished). QLS quoted with permission from the author.

S12-HoTARAC majority suggests amending the paragraph 23 of Appendix B and remove reference to ‘commercial’ or ‘market’ returns and instead to refer to ‘maximising returns, subject to the public service constraints the entity operates under’ or simply to refer to ‘positive’ returns. The respondent also recommended to assess the object of achieving of the financial return over the long-term period to avoid possibility of frequent change in entities’ classification.

**SMC 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 and why not?**

Opinion	Agree	Agree with Comments	Disagree	Unclear	No comments	Total
Respondents	<b>8</b> <b>5 Accounting firms</b> (S1-PwC, S2-Pitcher Partners, S3-KPMG, S10-GT, S13-Deloitte) <b>1 Professional body</b> (S4-CAANZ&CPA) <b>1 Preparer</b> (S12-HoTARAC) <b>1 Regulator</b> (S7-ACNC)	-	<b>3</b> <b>1 Accounting firm</b> (S11-EY) <b>2 Auditors</b> (S5-DH, S8-ACAG)	<b>1</b> <b>1 Professional Body</b> (S14-BCCM)	<b>4</b> <b>1 Accounting firm</b> (S9-SD) <b>1 Professional Body</b> (S6-AICD) <b>2 Others</b> (S15-LCA, S16-QLS)	<b>16</b>

**Issue 9: Impact of classification of the controlling entity on the classification of the group**

Three respondents (S5-DH, S8-ACAG, S11-EY) disagreed that classification of controlling entity would most likely determine the classification of the group in all circumstances, with one of the reason put forward that it is the characteristics of the group determining the classification of the group and the assumption of parent’s entity classification being the predominant factor of the classification of group may not be suitable for some of the groups where parent entity is not the trading or operating one.

**SMC 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 not-for-profit entity? Is this guidance sufficient? Why, or why not?**

Opinion	Agree	Agree with Comments	Disagree	Unclear	No comments	Total
Respondents	<b>5</b> <b>4 Accounting firms</b> (S1-PwC, S2-Pitcher Partners, S3-KPMG, S13-Deloitte) <b>1 Preparer</b> (S12-HoTARAC)	<b>1</b> <b>1 Accounting firm</b> (S10-GT)	<b>5</b> <b>1 Accounting firm</b> (S11-EY) <b>2 Auditors</b> (S5-DH, S8-ACAG) <b>1 Professional body</b> (S4-CAANZ&CPA) <b>1 Regulator</b> (S7-ACNC)	-	<b>5</b> <b>1 Accounting firm</b> (S9-SD) <b>2 Professional bodies</b> (S6-AICD, S14-BCCM), <b>2 Others</b> (S15-LCA, S16-QLS)	<b>16</b>

**Issue 10: Effective date of the proposals to be aligned with NFP financial reporting framework and interaction with proposals in ED 297**

Two respondents (S4-CAANZ&CPA, S8-ACAG) suggested delaying the finalisation of the proposed NFP definition and guidance until the AASB’s NFP financial reporting framework project is concluded “... so that entities need to transition to revised requirements only once ...” (S8-ACAG) and that “...it would be beneficial to ensure both “who” should report, and “what” should be reported are determined concurrently, in order to facilitate the identification of any further implementation issues” (S4-CAANZ&CPA).

S7-ACNC expressed concerns that if any registered charities are classified as a FP entity under the new proposed definition, they will be unable to apply NFP specific accounting requirements and at the same time, may have to prepare general purpose financial statements (GPFS) – provided they meet the reporting threshold – if the AASB’s proposals to remove special purpose financial statements for FP private sector entities (ED 297) are implemented. Similarly, S11-EY also suggested the Board to consider the consequences of ED 297 in conjunction with the impact of the proposed NFP definition.

**Issue 11: More guidance on differences in Australian accounting standards requirements for FP and NFP**

Three respondents (S5-DH, S10-GT, S11-EY) requested more guidance on the differences between accounting requirements for FP and NFP entities, given that some entities may change their classification under the proposed new definition. Areas need further guidance include valuation of assets not held primarily to generate cash flows, capital grants and revaluation model for property, plant & equipment (i.e. on the basis of classes of assets for NFP vs. individual assets for FP).

**Issue 12: Disclosure of the reasons for the classification as NFP/FP in the basis of preparation**

One respondent (S8-ACAG) recommended that the AASB consider “additional disclosure requirements regarding the underlying reasons for change in classification, to be disclosed preferably within the ‘basis for preparation disclosure’ as this significant change would be relevant to understanding the financial statements and may affect measurement basis” on initial application of the amending standard and recommends the AASB to consider amending the disclosure requirements under AASB 101 *Presentation of Financial Statements* to require entities to disclose the reasons why they are classified as FP or NFP given its impact on recognition, measurement, presentation and disclosure requirements.

**SMC 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?**

Opinion	Agree	Agree with Comments	Disagree	Unclear	No comments	Total
Respondents	<b>4</b> <b>4 Accounting firms</b> (S1-PwC; S2-Pitcher Partners; S3-KPMG; S13-Deloitte)	<b>1</b> <b>1 Auditor</b> (S5-DH)	<b>6</b> <b>2 Accounting firms</b> (S10-GT; S11-EY) <b>1 Auditor</b> (S8-ACAG) <b>1 Preparer</b> (S12-HoTARAC) <b>1 Professional Body</b> (S4-CAANZ&CPA) <b>1 Regulator</b> (S7-ACNC)	-	<b>5</b> <b>1 Accounting firm</b> (S9-SD) <b>2 Professional bodies</b> (S6-AICD, S14-BCCM), <b>2 Others</b> (S15-LCA, S16-QLS)	<b>16</b>

**Issue 13: Transitional relief**

Six respondents (S4-CAANZ&CPA, S7-ACNC, S8-ACAG, S10-GT, S11-EY, S12-HoTARAC) disagreed with the ED and required specific transitional requirements, in particular transitional relief for the restatement of the comparative periods and application of the amending standard prospectively rather than retrospectively, with some (S10-GT, S11-EY) recommending to the Board to consider modified retrospective approach similar to the one available in AASB 15. S12-HoTARAC also recommended the AASB to review the link between the proposed definition and the capital management provisions of AASB 101 (paragraphs 134-Aus 136.2).

The main areas that need transitional relief identified by the respondents (S5-DH, S8-ACAG, S10-GT) is property, plant and equipment revaluation model and impairment.

**SMC 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.**

Opinion	Agree	Agree with Comments	Disagree	Unclear	No comments	Total
Respondents	<b>11</b> <b>6 Accounting firms</b> (S1-PwC; S2-Pitcher Partners; S3-KPMG; S10-GT; S11-EY; S13-Deloitte) <b>2 Auditors</b> (S5-DH; S8-ACAG) <b>1 Professional body</b> (S4-CAANZ&CPA) <b>1 Preparer</b> (S12-HoTARAC) <b>1 Regulator</b> (S7-ACNC)	-	-	-	<b>5</b> <b>1 Accounting firm</b> (S9-SD) <b>2 Professional bodies</b> (S6-AICD, S14-BCCM), <b>2 Others</b> (S15-LCA, S16-QLS)	<b>16</b>
No substantive comments provided by the respondents.						

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

Opinion	Agree	Agree with Comments	Disagree	Unclear	No comments	Total
Respondents	<b>10</b> <b>6 Accounting firms</b> (S1-PwC; S2-Pitcher Partners; S3-KPMG; S10-GT; S11-EY; S13-Deloitte) <b>1 Auditors</b> (S8-ACAG) <b>1 Professional body</b> (S4-CAANZ&CPA) <b>1 Preparer</b> (S12-HoTARAC) <b>1 Regulator</b> (S7-ACNC)	-	<b>1</b> <b>1 Auditors</b> (S5-DH)	-	<b>5</b> <b>1 Accounting firm</b> (S9-SD) <b>2 Professional bodies</b> (S6-AICD, S14-BCCM), <b>2 Others</b> (S15-LCA, S16-QLS)	<b>16</b>
<p><b>Issue 14: Implementation guidance inconclusive</b></p> <p>One respondent (S5-DH) commented that the proposed guidance is confusing and inconclusive and examples are not particularly useful (see <a href="#">Issue 5, SMC 1</a>) and therefore they should not be mandatory.</p>						

	Agree	Agree with Comments	Disagree	No Comments	Total
<b>GMC8</b> (Appropriate application of NFP Standard-Setting Framework)	<b>7</b> <b>5 Accounting firms</b> (S1-PwC, S2-Pitcher Partners, S3-KPMG, S11-EY, S13-Deloitte) <b>1 Professional body</b> (S4-CAANZ&CPA <sup>17</sup> ) <b>1 Regulator</b> (S7-ACNC)	<b>2</b> <b>1 Auditor</b> (S8-ACAG): Majority agrees, however, required to elaborate on evidence in Basis for Conclusions Minority view: lack of evidence-based support (detail discussion in <a href="#">Issue 3, SMC1</a> ) <b>1 Preparer</b> (S12-HoTARAC minority) asserted that proposed definition for NFP have gone beyond the request by constituents (detail discussion in <a href="#">Issue 3, SMC1</a> )	<b>1</b> <b>1 Auditor</b> (S5-DH) suggested lack of evidence-based support (detail discussion in <a href="#">Issue 3, SMC1</a> )	<b>6</b> <b>2 Accounting firm</b> (S9-SD; S10-GT) <b>2 Professional bodies</b> (S6-AICD, S14-BCCM), <b>2 Others</b> (S15-LCA, S16-QLS)	<b>16</b>
<b>GMC9</b> (Regulatory issues including GFS implications)	Twelve respondents did not have substantive comments for this GMC, including ( <b>6 Accounting firms</b> (S1-PwC, S2-Pitcher Partners, S3-KPMG, S9-SD, S11-EY, S13- Deloitte); <b>1 Auditor</b> (S5-DH), <b>2 Professional bodies</b> (S6-AICD, S14-BCCM), <b>1 Preparer</b> (S12-HoTARAC), <b>2 Others</b> (S15-LCA, S16-QLS). Four respondents ( <b>1 Accounting firm</b> (S10-GT), <b>1 Professional body</b> (S4-CAANZ&CPA), <b>1 Regulator</b> (S7-ACNC), <b>1 Auditor</b> (S8-ACAG)) commented on the link between the proposed new definition and the concepts of NFP purposes other than financial reporting (detail discussion in <a href="#">Issue 1, SMC1</a> ).				
<b>GMC10</b> (Usefulness to users)	<b>6</b> <b>4 Accounting firms</b> (S1-PwC, S2-Pitcher Partners, S11-EY, S13-Deloitte) <b>1 Auditor</b> (S8-ACAG <sup>18</sup> ) <b>1 Preparer</b> (S12-HoTRAC)	<b>1</b> <b>1 Accounting firm</b> (S10-GT) commented that proposed changes are more beneficial for preparers than users	<b>3</b> <b>1 Accounting firm</b> (S3-KPMG) and <b>1 Auditor</b> (S5-DH) asserted there is no issue with current definition (detailed discussion in <a href="#">Issue 3, SMC1</a> ) <b>1 Regulator</b> (S7-ACNC) commented on classification for ACNC registered charities (detailed discussion in <a href="#">Issue 1, SMC1</a> )	<b>6</b> <b>1 Accounting firm</b> (S9-SD) <b>3 Professional bodies</b> (S4-CAANZ&CPA, S6-AICD, S14-BCCM) <b>2 Others</b> (S15-LCA, S16-QLS)	<b>16</b>

<b>GMC11</b> <b>(Best interest of economy)</b>	<b>7</b> <b>4 Accounting firms</b> (S1-PwC, S2-Pitcher Partners, S11-EY, S13-Deloitte) <b>1 Professional body</b> (S4-CAANZ&CPA) <b>1 Preparer</b> (S12-HoTARAC) <b>1 Regulator</b> (S7-ACNC)	-	<b>2</b> <b>1 Accounting firm</b> (S3-KPMG) and <b>1 Auditor</b> (S5-DH): Cost vs. benefit (detailed discussion in <a href="#">Issue 3, SMC1</a> )	<b>7</b> <b>2 Accounting firm</b> (S9-SD; S10-GT) <b>1 Auditor</b> (S8-ACAG) <b>2 Professional bodies</b> (S6-AICD, S14-BCCM) <b>2 Others</b> (S15-LCA, S16-QLS)	<b>16</b>
<b>GMC12</b> <b>(Cost and benefits of the proposals)</b>	<p>Fourteen respondents did not provide any substantive comments, including <b>7 Accounting firms</b> (S1-PwC, S2-Pitcher Partners, S3-KPMG, S9-SD, S10-GT, S11-EY, S13-Deloitte), <b>2 Auditors</b> (S5-DH, S8-ACAG), <b>3 Professional bodies</b> (SS4-CAANZ&amp;CPA, S6-AICD, S14-BCCM), <b>2 Others</b> (S15-LCA, S16-QLS)</p> <p>Two respondents provided following feedback:  <b>1 Preparer</b> (S12-HoTARAC) regards the costs of moving from ‘for-profit’ to ‘not-for-profit’ reporting as modest with a minority that suggested benefit of the change in the public sector does not appear to justify the efforts.  <b>1 Regulator</b> (S7-ACNC) estimates that over 300 charities will be impacted by proposals and believe it will impose reporting impost and administrative burden for those affected charities.</p>				

## APPENDIX B: OTHER MATTERS

Three respondents (S8-ACAG, S11-EY and S12-HoTARAC) have provided number of additional and editorial comments on the implementation guidance and illustrative examples that staff will consider when finalising the analysis of the responses.

<sup>17</sup> The concerns raised by S4-CAANZ&CPA that the development of a fit-for-purpose NFP financial reporting framework which the new NFP definition will underpin or cause divergence from the transaction neutral approach to standard-setting by the AASB will be considered in the NFP financial reporting framework project.

<sup>18</sup> Minority disagrees and asserts that the changes are not needed and would not be useful for users compared to the costs to be imposed.