Draft AASB Exposure Draft

ED XXX
Xx 2019

Amendments to Australian Accounting Standards – Not-for-profit definition and guidance

Comments to the AASB by xx/xx/2019

Australian Government

Australian Accounting Standards Board

Commenting on this AASB Exposure Draft

Comments on this Exposure Draft are requested by xx/xx/2019.

Formal Submissions

Submissions should be lodged online via the "Work in Progress – Open for Comment" page of the AASB website (www.aasb.gov.au/comment) as a PDF document and, if possible, a Word document (for internal use only).

Other Feedback

Other feedback is welcomed and may be provided via the following methods:

E-mail: standard@aasb.gov.au
Phone: (03) 9617 7600

All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chair of the AASB agrees to submissions being treated as confidential. The latter will occur only if the public interest warrants such treatment.

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Introduction

Australian Accounting Standards

The Australian Accounting Standards Board (AASB) develops, issues and maintains Australian Accounting Standards.

The AASB is a Commonwealth entity under the *Australian Securities and Investments Commission Act 2001*. AASB 1053 *Application of Tiers of Australian Accounting Standards* explains the two tiers of Australian Accounting Standards.

Exposure Drafts

The publication of an Exposure Draft is part of the due process that the AASB follows before making a new Australian Accounting Standard or amending an existing one. Exposure Drafts are designed to seek public comment on the AASB's proposals for new Australian Accounting Standards or amendments to existing Standards.

Why we are making these proposals

The classification of an entity as a for-profit **("FP")** entity or not-for-profit **("NFP")** entity is important because the application of the Australian Accounting Standards 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.

The distinction between a FP entity and NFP entity would become even more significant if the AASB develops a separate NFP reporting framework with simplified recognition and measurement criteria and the application of different tiers for NFP entities.

As part of the consultation undertaken in relation to the AASB's standard setting frameworks[1] at the end of 2017, the AASB asked for specific feedback in relation to the definition of a NFP entity, and whether there was sufficient guidance on how to distinguish entities as FP entities and NFP entities.

The majority of respondents supported retaining the term 'NFP', but requested more guidance from the AASB in determining whether an entity is a FP or NFP entity under the accounting standards.[2]

In addition, a clear majority of respondents supported the AASB monitoring and working with the NZASB on its project to update the definition of a public benefit entity **("PBE")**.

Several respondents noted the potential usefulness of the definition of a PBE as having a greater focus on the nature and purpose of a NFP/PBE. It provides a positive statement of what a NFP/PBE is, rather than what it is not.

Noting the feedback received, the Board decided in February 2018 to retain the term 'NFP entity' as a significant term for accounting purposes, but to consider at a later time amending the definition and guidance through monitoring the NZASB's project on improving the guidance on its definition of PBE.[3]

In December 2018, the XRB issued the XRB Exposure Draft 2018 *Amendments to XRB A1 Appendix A* ('XRB ED 2018') which proposes amendments to Appendix A of XRB A1 *Application of the Accounting Standards Framework*. Appendix A provides guidance to assist an entity in determining whether it is a PBE or a FP entity.

The AASB has reviewed the definition of PBE and the associated draft revised guidance and considers that it would generally be appropriate for use under the Australian standard setting framework, subject to certain limited amendments to adapt it for the Australian context.

[1] ITC 37 *The AASB's Standard Setting Frameworks for For-Profit Entities and Not-for-Profit Entities*
[2] For detailed summary of the feedback received on ITC 37 see staff paper 11.1 tabled at the February 2018 meeting (M162)
[3] Refer to: AASB Action Alert No 189, dated 15 February 2018

What we are proposing

This Exposure Draft proposes to:

(a) replace the definition of 'NFP entity' as currently included in AASB 102 *Inventories*, AASB 116 *Property, Plant and Equipment* and AASB 136 *Impairment of Assets* with the definition of 'PBE' as included in the XRB ED 2018 (amended as set out below), while retaining the term 'NFP entity'.

(b) issue the proposed amended guidance from the XRB ED 2018 (appropriately adapted for the Australian context) to assist entities applying the revised definition; and

(c) remove the NFP entity definition from AASB 102, AASB 116 and AASB 136 and instead include both, the revised definition and the guidance, in AASB 1057 Application of Australian Accounting Standards.

Replacing the definition

The term 'NFP entity' is currently defined in Australian Accounting Standards[4] as:

> *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 it controls.*

It is proposed to replace the definition of 'NFP entity' with the definition used for a PBE at paragraph 3 of the XRB ED 2018 (whilst retaining the term NFP), amended as follows:

> *an ~~reporting~~ 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.*

The definition is identical to the PBE definition in XRB ED 2018 except for the replacement of 'reporting entity' with 'entity'. The AASB does not believe that the reference to 'reporting entity' is necessary or adds anything further in defining 'NFP entity'. Furthermore, a reference to 'reporting entity' may cause confusion in the Australian context, in which it is currently defined differently to the definition contained in the IASB's revised *Conceptual Framework for Financial Reporting.*

The definition from the XRB ED 2018 aligns with that from the United Kingdom and has a greater focus on the nature and purpose of a NFP entity/PBE. It enables greater guidance to be provided for an entity to determine whether it a NFP or FP entity. In order to use the guidance from the NZ ED, it will be necessary to align the definition of NFP to the NZ definition of PBE.

Issuing the NZ guidance

The NZ definition of a PBE comprises two interdependent parts:

(a) the primary objective to provide goods or services for community or social benefit; and

(b) the provision of equity to support that primary objective rather than for a return to equity holders.

The proposed guidance clarifies that both parts of the definition need to be assessed in combination when determining an entity's classification. It sets out several indicators to be considered in determining whether an entity meets the definition of a PBE and discusses each of the indicators in turn. It acknowledges that in many cases it will be unlikely that any one indicator will be conclusive in determining whether an entity meets the definition of a PBE and it may be necessary to consider several indicators together. Professional judgement will be required when considering and balancing the assessment of each indicator.

The proposed guidance further provides examples to illustrate the application of the guidance.

The XRB ED 2018 contains a number of New Zealand specific references and examples which have been adapted to ensure that the ED is appropriate for the Australian context. The changes do not change the general principles of the proposed guidance.

[4] Refer to AASB 102. Aus6.1, AASB 116. Aus 6.1, AASB 136, Aus 6.2

How should the changes be implemented?

As discussed above, the definition of a NFP entity is currently included in three separate standards, being AASB 102. Aus 6.1, AASB 116. Aus 6.1, and AASB 136. Aus 6.2. However, neither of these are very obvious or logical. If the definition is to be revised and additional guidance provided, the AASB proposes that the definition is removed from the accounting standards referred to above and instead be included in one standard only, together with the associated guidance.

The following options of implementing the proposed changes have been considered:

(a) as amendments to AASB 1057

(b) as amendments to AASB 1053; or

(c) via a new, separate standard.

On balance, it is proposed that option (a) is the most appropriate, taking account of the objective of AASB 1057 to specify the types of entities and financial statements to which Australian Accounting Standards (including Interpretations) apply. The types of entities referred to in the objective of AASB 1057 would include NFP entities and it is proposed that it is appropriate that a NFP entity is defined in the Appendix to AASB 1057, and that the implementation guidance is also separately provided within AASB 1057, which would have mandatory status.

Application date

It is proposed that this would apply to annual periods beginning on or after xx xx xx, with earlier application permitted, provided that AASB 1058 is also applied at the same time.

We need your feedback

Comments are invited on any of the proposals in this Exposure Draft by xx xx xx. Submissions play an important role in the decisions that the AASB will make in regard to a Standard. The AASB would prefer that respondents express a clear overall opinion on whether the proposals, as a whole, are supported and that this opinion be supplemented by detailed comments, whether supportive or otherwise, on the major issues. The AASB regards supportive and non-supportive comments as essential to a balanced review of the issues and will consider all submissions, whether they address some or all specific matters, additional issues or only one issue (whether an issue specifically identified below or another issue).

Specific matters for comment

The AASB would particularly value comments on the following:

1. Do you agree that the current definition of NFP entity (as currently found in the Accounting Standards referred to above) should be replaced with the definition of PBE (without referring to reporting entity), but that the term NFP is retained? Why, or why not?

2. Do you agree that the guidance in the attached ED is appropriate and should be issued? Please indicate if you have concerns about particular parts of the guidance, or particular examples.

3. Do you agree that the definition and associated guidance should be included in AASB 1057 *Application of Australian Accounting Standards*? If not, please indicate your reasons and which alternative you would prefer.

4. Do you agree that the guidance should be issued as ‘implementation guidance’ which forms an integral part of AASB 1057, ie has mandatory status? Why, or why not?

General matters for comment

The AASB would also particularly value comments on the following general matters:

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

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

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

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

9. Unless already provided in response to specific matters for comment above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative? In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

Contents

Preface

Standards amended by 2018-X

This [draft] Standard makes amendments to AASB 102 *Inventories* (July 2015), AASB 116 *Property, Plant and Equipment* (October 2015), AASB 136 *Impairment of Assets* (August 2015), AASB 1057 *Application of Australian Accounting Standards* (November 2015).

Main features of this Standard

Main requirements

This [draft] Standard:

(a) replaces the definition of 'NFP entity' as currently included in AASB 102 *Inventories*, AASB 116 *Property, Plant and Equipment* and AASB 136 *Impairment of Assets* with the definition of 'PBE' as included in the NZ Exposure Draft *Amendments to XRB A1 Appendix A (When is an Entity a Public Benefit Entity)* (NZ ED) (as amended) while retaining the term 'NFP' entity'.

(b) issues proposed amended guidance based on the XRB ED 2018 to assist entities applying the revised definition; and

(c) removes the NFP entity definition from AASB 102, AASB 116 and AASB 136 and instead includes both, the revised definition and the guidance, in AASB 1057 *Application of Australian Accounting Standards*.

Application date

This [draft] Standard applies to annual periods beginning on or after xx xx xx, with earlier application permitted, provided that AASB 1058 is also applied at the same time.

[Draft] Accounting Standard AASB 2018-X

The Australian Accounting Standards Board makes Accounting Standard AASB 2018-X *Amendments to Australian Accounting Standards –Not-for-profit definition and guidance* under section 334 of the *Corporations Act 2001*.

Kris Peach

Chair – AASB

Dated … [date]

[Draft] Accounting Standard AASB 2018-X
Amendments to Australian Accounting Standards: Not-for-profit definition and guidance

Objective

This Standard amends:

(a) AASB 102 *Inventories* (July 2015)

(b) AASB 116 *Property, Plant and Equipment* (October 2015) and

(c) AASB 136 *Impairment of Assets* (August 2015)

(d) AASB 1057 *Application of Australian Accounting Standards* (November 2015)

Application

The amendments set out in this Standard apply to entities and financial statements in accordance with the application of the other Standards set out in AASB 1057 *Application of Australian Accounting Standards* (as amended).

This Standard applies to annual periods beginning on or after xx xx 2019. Earlier application of this Standard is permitted, provided AASB 1058 is also applied to the period.

This Standard uses underlining, striking out and other typographical material to identify some of the amendments to a Standard, in order to make the amendments more understandable. However, the amendments made by this Standard do not include that underlining, striking out or other typographical material. Amended paragraphs are shown with deleted text struck through and new text underlined. Ellipses (…) are used to help provide the context within which amendments are made and also to indicate text that is not amended.

Amendments to AASB 102 *Inventories* (July 2015)

Paragraph Aus6.1 is amended.

Aus6.1 The following terms are also used in this Standard with the meanings specified.

~~A *not-for-profit entity* is 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 it controls.~~

…

Amendments to AASB 116 *Property, Plant and Equipment* (October 2015)

Paragraph Aus6.1 is amended.

Aus6.1 The following terms are also used in this Standard with the meanings specified.

~~A *not-for-profit entity* is 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 it controls.~~

…

Amendments to AASB 136 *Impairment of Assets* (August 2015)

Paragraph Aus6.2 is amended.

Aus6.2 The following terms are also used in this Standard with the meanings specified.

~~A *not-for-profit entity* is 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 it controls.~~

…

Amendments to AASB 1057 *Application of Australian Accounting Standards* (November 2015)

The appendix is amended and new Implementation Guidance is inserted.

Appendix

Defined terms

This appendix is an integral part of AASB 1057.

…

not-for-profit entity	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.

…

Implementation Guidance: *When is an Entity a Not-for-Profit Entity?*

Purpose

1 The purpose of this Guidance is to assist an entity that prepares general purpose financial statements (GPFS) that complies with accounting standards issued by the Australian Accounting Standards Board (AASB) to determine whether or not it is a not-for-profit (NFP) entity.

2 The classification of an entity as a for-profit (FP) entity or a NFP entity is important because it determines which accounting standards and related accounting policies are applied by an entity. Inappropriate classification may result in the adoption of inappropriate accounting policies, and a failure to provide users with information appropriate to assessing the financial performance, financial position and service performance of an entity.

Definition of a NFP entity

3 NFP entities are defined as "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." NFP entities may be public sector entities or private sector entities.

4 The following definitions for public sector NFPs and private sector NFPs are referred to as:

(a) Public sector NFPs are NFPs that are public entities as defined in the Public Audit Act 2001, and all Offices of Parliament; and

(b) Private sector NFPs are NFPs that are not public sector NFPs.

5 FP entities are not defined. Rather, the term FP entities encompasses all entities other than NFP entities. An entity must assess whether it is a NFP or FP entity by considering whether or not it meets the definition of a NFP entity. Assessing whether an entity meets the definition of a NFP entity requires an entity to determine its primary objective.

6 In many cases it will be obvious whether an entity meets the definition of a NFP entity. For example, most charities registered under charities legislation are likely to meet the definition of a NFP entity although it is possible for a registered charity to be classified as a FP entity for financial reporting purposes. Similarly, many public sector entities operate under legislation that specifically requires them to provide goods or services for the benefit of the public. For example, the New Zealand Public Health and Disability Act 2000 requires this for District Health Boards.

7 In other cases it will not be immediately obvious that an entity is a NFP entity. Determining the primary objective of the entity (i.e. why the entity exists and what it intends to achieve) can be difficult where an entity has multiple objectives and such objectives are not ranked, or where the objectives are not clearly stated. In identifying the primary objective, it is necessary to assess the substance of the entity's purpose.

8 In this regard, it should be noted that the definition of a NFP entity comprises two interdependent parts: (i) the primary objective to provide goods or services for community or social benefit, and (ii) the provision of any equity is to support that primary objective rather than for a financial return to equity holders. Both parts of the definition need to be assessed in combination in determining an entity's classification. Assessing one of the parts alone is unlikely to be sufficient in determining whether an entity is a NFP or FP entity.

9 The legal form of an entity is unlikely to be a conclusive factor in determining whether or not an entity is a NFP entity. NFP entities are constituted in many different forms such as incorporated societies, trusts, statutory bodies and even companies. NFP entities include a wide range of entity types, including charities, clubs, and non- commercial public sector entities. They exist in the private sector and in the public sector and may be small or large.

10 Also, although in general terms NFP entities exist to provide goods and services for the community or social benefit, this does not necessarily imply that such entities exist for the benefit of the public as a whole. Many NFP entities exist for the direct benefit of a particular group of people, although it is also possible that society as a whole benefits indirectly. For example, a community football club exists to promote and encourage football for the direct benefit of its members. However, society as a whole may also benefit indirectly through a healthier population and through the provision of organised activities for its youth.

11 This Guidance sets out several indicators to be considered in determining whether an entity meets the definition of a NFP entity. In many cases it will be unlikely that any one indicator will be conclusive in determining whether an entity meets the definition of a NFP entity and it may be necessary to consider several indicators together. Professional judgement is required when considering and balancing the assessment of each indicator.

12 The assessment for classification as a NFP or FP entity is made at the reporting entity level. As a result, the classification at the reporting entity level may differ from the classification at the group level. Therefore, where an entity is a subsidiary of another entity and the subsidiary entity is a reporting entity with its own reporting obligations, the subsidiary assesses its own primary objective for reporting purposes. In determining the classification of a group, it is necessary to consider the characteristics of the group. The classification of the controlling entity of the group would most likely determine the classification of the group.

Indicators

13 Paragraphs 14 to 37 discuss key indicators that aim to focus on the substance of an entity's purpose and which should be considered in determining whether an entity is a NFP entity. These indicators are:

- the stated objectives;
- the nature of the benefits, including the quantum of expected financial benefits;
- the primary beneficiaries of the benefits;
- the nature of any equity interest;
- the purpose and use of assets; and
- the nature of funding.

Stated objectives

14 In many cases the governing legislation, a constitution, a trust deed, or other founding documents will specify the objectives of an entity, including for whom the benefits generated by the entity are intended. For example, the State-Owned Enterprises Act 1986 states that the principal objective of every State enterprise is to "operate as a successful business and to this end, to be:

(a) as profitable and efficient as comparable businesses that are not owned by the Crown; and a good employer; and

(b) an organisation that exhibits a sense of social responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate or encourage these when able to do so."[52].

15 The founding documents of an entity may also specify the objective of an entity in terms of the nature of the benefits the entity provides. For example, one of the objectives of District Health Boards is to improve, promote and protect the health of people and communities.

16 In the private sector, the meaning of charitable purpose is set out in the Charities Act 2005. In that Act, "charitable purpose includes every charitable purpose, whether it relates to the relief of poverty, the advancement of education or religion, or any other matter beneficial to the community."[63]

17 Many entities are established with multiple objectives. For example, Crown Research Institutes (CRIs) are required by the Crown Research Institutes Act 1992 (CRI Act) to:

- undertake research for the benefit of New Zealand;
- comply with any applicable ethical standards;
- promote and facilitate application of the results of research and technological developments;
- be a good employer and exhibit a sense of social responsibility; and
- operate in a financially responsible manner so that they maintain their financial viability.

5 Section 4 State-Owned Enterprises Act 1986
6 Section 5(1) Charities Act 2005

18 Where an entity's founding documents provide that an entity has multiple objectives, determining the primary objective will depend on an assessment of the substance of the purpose of the entity.

19 In assessing the substance of the purpose of the entity where there are multiple objectives, it may be helpful to consider how the entity assesses its performance, as this may indicate which of its stated objectives is its primary objective. For example, if the entity has performance targets for a rate of return on assets or a percentage of return to equity holders, this may indicate the entity is a FP entity. However, if the performance targets focus on the level/amount of benefits that have been delivered to achieve a community or social outcome, this may indicate that the entity is a NFP entity.

20 The founding documents may require an entity to be financially viable or to generate an adequate rate of return. However, being financially viable is not in itself conclusive in distinguishing a FP entity from a NFP entity. There is often a community expectation that NFP entities will be financially viable and operate to ensure that the limited resources at their disposal are used effectively.

Nature of the benefits, including the quantum of expected financial benefits

21 The nature of the benefits provided by an entity including the quantum of the expected financial benefits, may indicate whether an entity is a NFP entity.

22 Unlike FP entities, NFP entities do not exist to generate a financial surplus in order to provide a financial benefit/return to equity holders. Instead, they exist to provide goods or services for community or social benefit. Hence, if an entity provides goods or services to recipients at no cost or for nominal consideration, the entity is likely to be a NFP entity. This does not imply that NFP entities never generate, or aim to generate, a financial surplus on the net assets employed. However, where a NFP entity does generate a financial surplus, it may be required or expected to be used to support the entity's primary objective of providing goods or services for community or social benefit, rather than for providing a financial benefit to equity holders.

23 NFP entities may establish controlled entities or discrete business units which operate to generate a financial surplus that can be used to support the primary activities of the controlling entity. Such entities or business units may be for-profit. This fact does not affect the classification of the controlling entity or group.[7]

24 The benefits provided by FP entities are financial in nature. Most FP entities aim to generate a commercial or market return – that is, to maximise the financial benefit/return to equity holders commensurate with the relative risks of operating. Hence, the quantum of the expected financial benefits may indicate whether an entity is a FP entity or a NFP entity.

25 When considering the quantum of the expected financial benefits and the nature of the benefits provided by an entity, it is important to recognise that the generation of profits and payment of dividends is only one form of financial benefit that can be provided to equity holders. There are many other forms of financial benefit that can be returned to members or equity holders. For example, cooperatives provide a financial benefit to members by paying a rebate based on the volume of transactions with the entity rather than through the payment of dividends. Another example of a financial benefit is the provision of discounted goods and services by an entity to its members.

Primary beneficiaries of the benefits

26 An understanding of who the primary beneficiaries of the benefits provided by the entity are (i.e. the people who primarily benefit from the activities of the entity) will assist in determining whether an entity is a NFP entity.

27 Typically, the primary beneficiaries of a FP entity are its equity holders (including its parent, where the reporting entity is controlled by another entity)[8] or other providers of economic resources to the entity (such as debt holders or suppliers). These parties provide economic resources to the entity in exchange for an entitlement to financial returns.

28 In contrast, as the primary objective of a NFP entity is to provide goods or services for community or social benefit, typically the primary beneficiaries of NFP entities are members of the community (or a particular section of the community), rather than resource providers.

[7] If a controlled entity or business unit is required to prepare general purpose financial statements its classification is determined by its own primary objective and not that of the controlling entity of the group.

[8] As noted in paragraph 12, the assessment of the classification of an entity as a NFP or FP entity is made at the reporting entity level. Where the reporting entity is controlled by a NFP entity, how the NFP parent uses the financial returns provided by the reporting entity to its parent is not relevant to the assessment of whether the reporting entity should be classified as a FP or NFP entity.

29 If the entity is membership based and the primary beneficiaries of the benefits provided by the entity are not members of the entity, the entity is likely to be a NFP entity. For example, a heritage trust where membership monies are used for maintaining and enhancing heritage assets for the benefit of the wider community. However, 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 discussed in this Guidance).

Nature of equity interest

30 Where an entity is established to generate a financial return for the benefit of the equity holders the ownership instrument is usually clearly defined. This is important for FP entities because it determines the level of financial benefits/returns such as dividends and rights to the residual net assets. If an entity does not have any clear equity holders or the nature of the equity instrument is unclear, the entity is likely to be a NFP entity.

31 The absence of clear equity holders may manifest itself in a number of ways, including:

- the absence of an individual or entity having a right to participate in any financial return or in the net assets of the entity were it to be wound up or otherwise cease to operate; or
- a requirement that in the event the entity ceases operating any residual net assets are to be applied to another entity with a similar purpose or to revert to another NFP entity. That is, the use of the assets is effectively restricted to providing goods or services for community or social benefit.

Purpose and use of assets

32 The reasons an entity acquires and/or holds an asset may indicate whether it is a NFP entity. FP entities hold assets mainly for sale or for generating a financial benefit for equity holders. The primary reason NFP entities (particularly public sector NFP entities) hold property, plant and equipment and other assets (including infrastructure assets) is usually for their potential to provide future services for community or social benefit rather than their ability to generate a financial benefit for equity holders. If an entity holds assets primarily for delivering future services for community or social benefit, the entity is likely to be a NFP entity.

33 For example, NFP entities may hold assets that contribute to the historical and cultural character of a nation or region, such as art treasures, historical buildings and other artefacts. Other NFP entities may be responsible for national parks and other areas of natural significance with native flora and fauna. Such historical items and land are generally not held for sale, even if a market exists. Rather, the respective NFP entities have a responsibility to preserve and maintain them for current and future generations.

Nature of funding

34 If an entity relies wholly or primarily on donations or other contributions whereby the resource provider does not receive an entitlement to financial returns (or other economic resources) from the entity in return, the entity is likely to be a NFP entity.

35 Many NFP entities are dependent on grants and donations. In addition, the sources of funding are usually from third parties (i.e. a source other than the beneficiaries of their services). For example, public sector NFP entities receive appropriations and other public funds to carry out their services. Private sector NFP entities may rely on government grants, donations from philanthropic organisations and donations and bequests from the public. There may also be restrictions imposed by the provider of the funding on how the funds may be spent.

36 NFP entities also receive funding through the provision of donated services. For example, many NFP entities rely heavily on volunteers (rather than paid employees) to deliver their services to the community.

37 In contrast, FP entities are funded primarily by equity holders, debt holders and other suppliers of economic resources, in exchange for an entitlement to dividends, interest and other forms of financial returns (or other economic resources).

Conflicting indicators

38 When considering the classification of an entity, in some cases the above indicators may conflict with each other and the primary objective or purpose of the entity may not be obvious. Some indicators may indicate that an entity should be classified as a FP entity and others may indicate the entity should be classified as a NFP entity. In this situation professional judgement is required to evaluate the indicators overall and in combination with each other, including the significance of particular indicators to the overall assessment, to

determine whether, in substance, the entity meets the definition of a NFP entity. For example, if the entity has only a small amount of equity, considering the nature of its equity interest may be less helpful than the other indicators when determining whether, in substance, the entity meets the definition of a NFP entity.

Changing classification

39 Although not expected to be common, changing circumstances may lead to a change in an entity's classification from a NFP to a FP entity and vice versa. For example, the constitution of an entity may be amended to change an entity's primary objective from one that is FP focused to one that is NFP focused.

40 Accounting for a change in classification depends on the applicable accounting requirements of the new classification. An entity will need to first determine its applicable tier of financial reporting, in accordance with XRB A1. XRB A1 paragraphs 14–30 set out the Tier structure for for-profit entities, and paragraphs 31–72 set out the Tier structure for PBEs. The entity would then need to apply the applicable accounting requirements for its tier of financial reporting, including the requirements on the first-time adoption of that tier of reporting. For example, if an entity's classification changes from a PBE to a for-profit entity, the entity would need to apply NZ IFRS 1 *First-time Adoption of New Zealand Equivalents to International Financial Reporting Standards.*

ILLUSTRATIVE EXAMPLES: Determining whether or not an entity is a NFP entity

41 The following examples aim to illustrate application of this Guidance. The examples are illustrative only and do not establish requirements.

42 While specific types of entity are referred to in the examples, the circumstances in relation to individual entities may vary significantly, and therefore the examples do not conclude as to whether the entity in question is or is not a NFP entity. Rather, the examples illustrate indicators to be considered by preparers in reaching a conclusion regarding whether or not an entity is a NFP entity. In assessing this classification an appropriate weighting needs to be given to each individual indicator. Depending on the circumstances some indicators will provide a stronger indication than others about whether or not an entity should be classified as a NFP entity. The entity will need to consider each indicator against the other indicators and make an overall assessment of whether or not the entity is a NFP entity.

Example 1: Crown Research Institute (CRI)

Entity A is a company established under section 11 of the Crown Research Institutes Act 1992 (the CRI Act).

Stated objectives

The CRI Act states that the purpose of every CRI is to undertake research (section 4) and sets out the principles of operation CRIs are expected to follow in fulfilling this purpose. These principles are set out in section 5 of the Act and include, for example, that a CRI should undertake research for the benefit of New Zealand, operate in a financially responsible manner and be a good employer.

The CRI Act establishes a broad framework for the operation of CRIs. The primary objective (purpose) of CRIs is clearly stated in the CRI Act. The principles set out in section 5 are detailed, but they are not ranked and their implementation can be achieved in a number of ways. CRIs, therefore, appear to have discretion as to how they can achieve their purpose.

Nature of the benefits, including the quantum of expected financial benefits

The key benefit of establishing CRIs is the production of research that will benefit New Zealand. In one sense the CRIs undertake research for community or social benefit. The New Zealand economy and entities operating in New Zealand can benefit from the research undertaken.

However, there may be discretion as to how research findings are distributed, in determining the nature of the research to be undertaken and whether the entity intends to generate a financial return for its equity holder (i.e. the Shareholding Minister).

If Entity A distributes the research findings to its customers on a fee-for-service basis with the aim of generating a financial surplus for its equity holder equivalent to a market return, this may indicate that Entity A is a for-profit entity.

If however Entity A undertakes research of a nature that will benefit New Zealand more broadly and makes its research findings available free of charge or for a nominal charge then the benefits provided would be community/social in nature, which may indicate that Entity A is a PBE.

Primary beneficiaries of the benefits

Although Entity A is a company, the primary beneficiaries of the benefits may not necessarily be the Shareholding Minister or the Government.

If the CRI sells its research on a commercial basis for the purpose of providing a financial return to the Shareholding Minister (i.e. the equity holder) then the primary beneficiary would be the entity’s equity holder, which may indicate that Entity A is a for-profit entity.

Whereas if the research findings are made available for a nominal fee or free of charge for the benefit of the wider community, such as all entities operating in New Zealand with an interest in those research findings, then the primary beneficiaries would be the wider community, which may indicate that Entity A is a PBE.

Nature of equity interest

Entity A is a company. The equity interest is in the form of shares owned by the Shareholding Minister. In the case of Entity A, the nature of the equity interest is clear. In addition, there is no restriction on the use of assets in the event Entity A is sold, wound up or ceases to operate. This may indicate that Entity A is a for-profitentity.

Conversely, if the company constitution provides that in the event Entity A is wound up, or otherwise ceases to operate, its net assets are required to be transferred to another entity with a similar purpose, this may indicate that Entity A is PBE.

Purpose and use of assets

Entity A owns property, plant and equipment that it uses to undertake research and produce research reports. If Entity A holds those assets to sell or to generate a commercial financial return for the Shareholding Minister, this may indicate that Entity A is a for-profit entity.

However, if the property, plant and equipment is used to undertake research and report on the research findings for the benefit of the New Zealand public then the assets would be held for their potential to provide services to the community, which may indicate that Entity A is a PBE.

Nature of funding

Entity A competes for funding from government and private sources.

If the CRI funds its research activities primarily through charging commercial fees to customers for research services, this may indicate that Entity A is a for-profit entity.

Conversely, if, funding is derived primarily through government grants and donations from private organisations, and there is no requirement to deliver research findings to those funding organisations in return, this may indicate that Entity A is a PBE.

Example 2: Bicycle Shop

A charitable trust is established with the objective of providing health services to the homeless. The Trust receives an annual grant from the Government. The grant is sufficient to cover operating costs necessary to provide basic health care services to a limited number of people. To meet the increasing demand for its services and to fund an expanded range of services, the Trust establishes a bicycle shop (Company 1).

Company 1 sells second hand bicycles and runs a successful bicycle hire service. All surpluses from Company 1 are returned to the Trust to support the primary objective of providing health services to the homeless.

Stated objectives

Company 1's constitution specifies that its objective is to raise funds to support the charitable trust. Therefore, as the entity's stated objective is to generate financial returns for its equity holder, this may indicate that the entity is a FP entity.

Conversely, if the entity's stated objective was to provide some form of community or social benefit (e.g. to provide employment for the homeless), this may indicate that the entity is a NFP entity.

Nature of the benefits, including the quantum of expected financial benefits

Company 1 returns financial surpluses generated through the sale and hire of bicycles to the Trust.

If bicycles are sold and hired at market rates with a view to maximising the financial surplus returned to the Trust, then the nature of the benefits would be financial, which may indicate that the bicycle shop is a FP entity.

However, if the shop is used primarily to provide employment to the homeless, and/or the bikes are sold at below market rates or hired out at a nominal/low rate to enable the disadvantaged to benefit from exercise (with any incidental financial surplus returned to the Trust), then the entity would be providing community or social benefits, which may indicate that Company 1 is a NFP entity.

Primary beneficiaries of the benefits

If bicycles are sold and hired at market rates and the primary beneficiary of the financial surpluses derived is the Trust (i.e. the equity holder), then this may indicate that Company 1 is a FP entity.

However, if any financial surplus derived by Company 1 is incidental to employing the homeless and/or providing affordable access to bicycles for the disadvantaged, then this may indicate that Company 1 is a NFP entity. In this case, the primary beneficiaries of the benefits (employment and bicycle affordability) provided by Company 1 are the homeless and the disadvantaged.

Nature of equity interest

Company 1 is 100% owned and controlled by the Trust. As such the ownership arrangement and equity holder is clear.

If in the event Company 1 ceases trading the trustees are able to determine how to use any residual assets of Company 1, then this may indicate that Company 1 is a FP entity.

However, if the trust deed provides that in the event Company 1 ceases trading any residual assets must be donated to a charity that fulfils the same or a very similar charitable purpose to that of the Trust, then this may indicate that Company 1 is a NFP entity.

Purpose and use of assets

If the directors of Company 1 aim to ensure that the return on the net assets invested in the shop is at least equivalent to a market return, they may recommend that the Trust invest its funds in another activity if a market return is not achieved. This may indicate that Company 1 is a FP entity.

However, if Company 1 was operated with the objective of generating a sufficient return on the net assets for it to continue to be a viable organisation, with no reference to a market return on the net assets invested, and instead its assets were used to provide goods or services for community or social benefit (i.e. enabling the disadvantaged to benefit from exercise) this may indicate that Company 1 is a NFP entity.

Nature of funding

Company 1 funds its activities through the sale and hire of bicycles. The Trust provided a small capital contribution to ensure the shop could purchase bicycles in addition to any that were donated. Company 1 pays a small rental to the Trust. Other outgoings are minimal and there are no borrowings.

If a significant number of the bicycles for hire and for sale were donated by members of the community, this may indicate that Company 1 is a NFP entity. Similarly, if most of the employees of Company 1 are volunteers, this may indicate that Company 1 is a NFP entity.

If, however, the funding is derived primarily from the sale and hire of bicycles at normal commercial rates and the Trust expects a return on its investment, this may indicate that Company 1 is a FP entity.

Example 3: Private Education Organisation

Entity B is a private organisation dedicated to providing low-cost high-quality education to children who immigrated to Australia from poverty-stricken countries. Entity B was established as a Trust with an initial endowment of $5m from the estate of a wealthy business person.

In order to supplement its income Entity B accepts a limited number of fee-paying students. The fees for such students were determined after market research into the pricing of such services. All fee revenue is applied by Entity B to its objective of providing high-quality education to children who immigrated to Australia from poverty-stricken countries. The revenue from fee-paying students has enabled Entity B to expand the range of services it offers and to expand its roll of immigrant children.

The trustees carefully manage the resources of Entity B in order to maximise the number of immigrant children it can accept and to maintain a high-quality educational service. The trustees have a clear operational plan and have established clear financial targets in order to achieve the trust's objectives.

Stated objectives

The trust deed establishing Entity B states that the purpose of Entity B is to provide high-quality education to children who immigrated to Australia from poverty-stricken countries.

As Entity B's objective is to provide high-quality education to immigrant children from poverty-stricken countries (i.e. to provide a community or social benefit), this may indicate that Entity B is a NFP entity.

If the trust deed states that Entity B's purpose is to maximise its financial surplus from fee-paying students while also providing high-quality education to immigrant children, this may indicate that Entity B is a FP entity.

Nature of the benefits, including the quantum of expected financial benefits

The nature of the benefits provided by Entity B are the educational services delivered to children from poverty-stricken countries. The equity has been provided to Entity B for the benefit of immigrant children and not for the generation of a financial return for equity holders. The nature of the benefits provided is primarily community/social, which may indicate that Entity B is a NFP entity.

If the financial targets established by the trustees are expressed in terms of meeting the development targets set out in the operational plan rather than being expressed in terms of a return on equity, this may indicate that Entity B is a NFP entity.

However, if the financial targets are expressed in terms of a return on equity, this may indicate that Entity B is a FP entity.

If Entity B established a subsidiary entity through which it ran its commercial education operations to maximise profits to be paid back to the Trust, then that subsidiary may be a FP entity. In this case it would also be necessary to consider whether the group reporting entity is a NFP entity by considering the characteristics of the controlling entity of the group.

Primary beneficiaries of the benefits

If the objective of Entity B is to provide high-quality education to immigrant children, with any surplus generated used to expand the number of immigrant children who are provided with high-quality education, the primary beneficiaries are the immigrant children. This may indicate that Entity B is a NFP entity.

If the trust deed identifies specific parties as beneficiaries of the trust (i.e. not the immigrant children) and Entity B limits the amount of surplus used to expand the education programme to immigrant children in order to generate a financial return for the specified beneficiaries, this may indicate that Entity B is a FP entity.

Nature of equity interest

Entity B is a trust, so there are no clearly defined ownership instruments.

The trust deed requires that in the event Entity B ceases operating any residual assets are to be distributed to another entity with a similar purpose. The use of the assets is restricted, and there are no clear equity holders that have an entitlement to those assets. This may indicate that Entity B is a NFP entity.

If the trust deed provides that in the event Entity B ceases operating any residual assets are to be distributed to other specified parties (e.g. the specified beneficiaries), this may indicate that Entity B is a FP entity.

Purpose and use of assets

Entity B provides education to both immigrant children and to fee-paying students. The trustees have a clear operational plan and have established clear financial targets to achieve the trust's objectives.

If Entity B uses its assets to provide high-quality education to immigrant children from poverty-stricken countries, rather than to generate a financial return on its equity then this may indicate that Entity B is a NFP entity.

If the trustees of Entity B require a commercial financial return on those assets, this may indicate that Entity B is a FP entity.

Nature of funding

Entity B receives funding from several sources: investment income from the initial endowment, income from fee-paying students, and donations from the public and fundraising activities.

If this funding is derived predominantly from third parties who do not benefit from Entity B's services, and the resource provider does not receive an entitlement to financial returns (or other economic resources), this may indicate that Entity B is a NFP entity.

If Entity B derives its funding predominantly from fee-paying students and other resource providers in exchange for an entitlement to financial returns (or other economic resources) from the entity, this may indicate that Entity B is a FP entity.

Example 4: Sports Club

Club AFC is a football club established in a suburb of a large city. Club AFC organises competitions and provides coaching and training for a wide range of age groups, from five-year-olds through to senior grade, and representative grades.

Stated objectives

Club AFC is established as a charitable trust. Its constitution states that it is a non-profit entity established to foster participation and to promote amateur football in its suburb. This indicates that Club AFC may be a NFP entity.

If, however, the constitution stated that Club AFC's objective is to maximise profits for the club, then this may indicate that Club AFC is a FP entity.

Nature of the benefits, including the quantum of expected financial benefits

The benefits provided by Club AFC arise from the coordination of football competitions and the provision of football coaching and training to club members. This may indicate that Club AFC is a NFP entity.

If Club AFC were to sell a significant amount of its coaching, and training services (e.g. to schools, other football clubs, or individuals) at normal market rates, with the aim of generating financial returns for its members this may indicate that Club AFC is a FP entity.

If Club AFC uses the surpluses from selling its services to ensure the Club remains financially viable with any surplus used to develop the services it offers to club members and the wider amateur football community, this many indicate that Club AFC is a NFP entity.

If the financial targets are set with the objective of generating a commercial rate of return for its members, this may indicate that Club AFC is a FP entity.

Primary beneficiaries of the benefits

Club AFC provides training and coaching for all age groups and grades of players who are members of the club. The Club also organises football competitions in which other amateur football clubs participate.

If the Club's activities primarily benefit the wider community (for example, by promoting soccer as part of a keeping active programme, providing some coaching at no cost for schools or providing free soccer memberships for disadvantaged children in the community), this may indicate that Club AFC is a NFP entity.

If, however, the primary beneficiaries of the Club's activities are the members of Club AFC, it is necessary to consider other factors (for example, the nature of the benefits and other indicators discussed in this Guidance) to determine whether the entity is a NFP entity.

Nature of equity interest

Club AFC is a member-based entity and there are no clear equity holders. This may indicate that the Club is a NFP entity. If, however, the Club was owned by shareholders expecting a financial return on their investment in the Club, this may indicate that the Club is a FP entity.

If the constitution states that in the event the Club is wound up or ceases operating, any residual assets are to be applied to an organisation with a similar purpose as Club AFC, this may indicate that the Club is a NFP entity.

However, if the constitution states that in the event the Club is wound up or ceases to operate any residual assets are to be distributed to the members, this may indicate that the Club is a FP entity.

Purpose and use of assets

Club AFC's assets comprise primarily football equipment (nets, balls, uniforms etc), as well as tripods and filming technology used to analyse matches for the purpose of coaching and training. A small shed is leased at the local community centre to store the equipment.

If the Club's assets are used primarily to provide coaching, training and competitions for amateur players in the community, then this may indicate that Club AFC is a NFP entity.

However, if Club AFC sells a significant amount of its coaching and training services and charges commercial market rates to other individuals or entities for using its tripods and filming technology, then its assets may be generating a financial return for its members. This may indicate that the Club is a FP entity.

Nature of funding

Club AFC receives funding from membership fees, donations, sponsorship and community grants.

If this funding does not establish a financial interest in the Club, this may indicate that Club AFC is a NFP entity.

If Club AFC receives funding primarily from members and other resource providers who are expecting either a financial return on their investment or other economic resources in return for providing funds, this may indicate that Club AFC is a FP entity.

Example 5: Social Enterprise

The social enterprise model is becoming a more prevalent way for entities to operate. It is important to note that an entity that identifies itself as a social enterprise may not necessarily be a NFP entity. It is possible for an entity that identifies itself as a social enterprise to be a FP entity that also has a social objective.

Entity C is a company which donates one lunch for a hungry school child at a low decile school for every lunch that it sells to the public, that is, the cost of the donated lunch is built into the cost of the lunch that is sold.

Stated objectives

Entity C's constitution states that its objective is to provide healthy food, including lunches, to patrons and to children at low decile schools.

If Entity C's constitution states that its objective is to help children at low decile schools by providing healthy lunches, this may indicate that Entity C is a NFP entity.

If Entity C's objective is to maximise profits while also achieving a social objective of providing healthy lunches to children at low decile schools, this may indicate that Entity C is a FP entity.

Nature of the benefits, including the quantum of expected financial benefits

If Entity C generates substantial surpluses, after covering the costs of free lunches, with those surpluses distributed to its shareholders or retained for additional business investments, the nature of the benefits provided are primarily financial. This may indicate that Entity C is a FP entity.

If Entity C uses the surpluses from the sale of lunches primarily to fund the costs of the free lunches and other operating costs, with any surplus used to expand the number of free lunches provided to school children, the nature of the benefits provided are primarily community/social. This may indicate that Entity C is a NFP entity.

Primary beneficiaries of the benefits

Entity C has three shareholders.

If Entity C limits the amount of its surplus from the sale of lunches that can be used to provide free lunches, to ensure that it generates an adequate financial return for its shareholders, the primary beneficiaries are the shareholders, which may indicate that Entity C is a FP entity.

Conversely, if Entity C uses most of the surpluses from the sale of lunches to provide free lunches to children in low decile schools rather than distributing the profits to its shareholders, the primary beneficiaries are the children at low decile schools. This may indicate that Entity C is a NFP entity.

Nature of the equity interest

Entity C has two founding shareholders. To enable expansion plans to be completed, additional shares were issued to a shareholder who has a prominent business in the food distribution sector. The equity holders are clearly identifiable by the equity instruments they hold.

If:

(a) there were no entitlements to dividends;

(b) all profits were reinvested in Entity C; and

(c) on Entity C ceasing to operate, any residual assets were to be donated to an entity with a similar charitable objective,

this may indicate that Entity C is a NFP entity .

If Entity C's shareholders have an entitlement to dividends and to a share of the residual net assets of the entity if it is wound up, this may indicate that Entity C is a FP entity.

Purpose and use of assets

Entity C acquires or holds its assets to provide healthy lunches for children in low decile schools and to make lunches and healthy food that are sold to the public.

If the assets are used primarily to provide healthy lunches for children in low decile schools, this may indicate that Entity C is a NFP entity.

If Entity C acquires or holds its assets primarily to sell or to generate financial benefits for its equity holders, this may indicate that Entity C is a FP entity.

Nature of Funding

Entity C's equity was initially provided by shareholders.

If Entity C relies primarily on donations and grants from the general public and funding organisations, and has a predominantly volunteer workforce, this may indicate that Entity C is a NFP entity.

If Entity C's funding is provided primarily by shareholders and other resource providers in exchange for an entitlement to financial returns (e.g. dividends) or other economic resources, this may indicate that Entity C is a FP entity.

Part D: Effective date

This [draft] Standard is effective for periods beginning on or after [], with earlier application permitted.

Commencement of the legislative instrument

For legal purposes, this legislative instrument commences on xx xx xx .