AASB Exposure Draft

ED 291
June 2019

Not-for-Profit Entity Definition and Guidance

Comments to the AASB by 9 September 2019

Australian Government

Australian Accounting Standards Board

Commenting on this AASB Exposure Draft

Comments on this Exposure Draft are requested by 9 September 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.

ISSN 1030-5882

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 a 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 a NFP entity would become even more significant if the AASB develops a separate NFP entity financial reporting framework with simplified recognition and measurement requirements and different reporting tiers for NFP entities.

As part of the consultation undertaken in relation to the AASB's standard-setting frameworks in 2017[1], the AASB asked for specific feedback regarding 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 'not-for-profit entity', but requested more guidance from the AASB in determining whether an entity is a FP or NFP entity under the accounting standards.

In addition, a majority of respondents supported the AASB monitoring and working with the New Zealand Accounting Standards Board (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. Contrary to the current AASB definition of a NFP entity, it would provide 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 'not-for-profit 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.

In December 2018, the New Zealand External Reporting Board (XRB) issued the XRB Exposure Draft *2018 Amendments to XRB A1 Appendix A*, which proposed amendments to Appendix A of XRB Standard A1 *Application of the Accounting Standards Framework.* Appendix A provides guidance to assist an entity in determining whether it is a PBE or FP entity. The New Zealand amendments have now been finalised as proposed in the XRB ED through the issue of the XRB Standard *2019 Amendments to XRB A1 Appendix A* (May 2019).

The AASB has reviewed the XRB definition of PBE and the associated 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.

What we are proposing

This Exposure Draft proposes to:

1 See Invitation to Comment ITC 37 *The AASB's Standard-Setting Frameworks for For-Profit Entities and Not-for-Profit Entities* (October 2017).

(a) retain the term 'not-for-profit entity' but replace the definition of not-for-profit entity as currently included in AASB 102 *Inventories*, AASB 116 *Property, Plant and Equipment* and AASB 136 *Impairment of Assets* with the definition of public benefit entity as included in XRB A1 Appendix A – but amended as set out below;

(b) develop implementation guidance based on XRB A1 Appendix A (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 'not-for-profit entity' is currently defined in Australian Accounting Standards 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 that it controls.* (AASB 102, paragraph Aus6.1)

It is proposed to replace the definition of a NFP entity with the definition of a PBE at paragraph 3 of XRB A1 Appendix A (whilst retaining the term NFP), amended as follows:

> *~~reporting entities~~* <u>an entity</u> *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 A1 Appendix A except for the replacement of 'reporting entity' with 'entity'. The AASB does not consider that the reference to 'reporting entity' is necessary or adds anything further in defining a NFP entity. Furthermore, a reference to 'reporting entity' may cause confusion in the Australian context, given the different meanings for the term in the new *Conceptual Framework for Financial Reporting* and in Australian Accounting Standards, applying to different sets of entities.

The definition from XRB A1 Appendix A aligns with that used in the United Kingdom and has a greater focus on the nature and purpose of a NFP entity/PBE. It gives greater guidance to an entity in determining whether it is a NFP or FP entity.

Implementation guidance

Aligning the definition of NFP entity to the NZ definition of PBE permits the adoption of the guidance in XRB A1 Appendix A, adapted for the Australian context.

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 (if any) to support that primary objective rather than for a financial 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 NFP entity 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 NFP entity and it may be necessary to consider several indicators together. Professional judgement would be required when considering and balancing the assessment of each indicator.

Illustrative examples are also proposed to assist with applying the guidance.

The XRB A1 Appendix A 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. These changes do not alter the general principles of the guidance. A marked-up version of the relevant text of XRB A1 Appendix A is available on the AASB website to indicate the changes proposed to the NZ text for the purposes of this ED.

How should the changes be implemented?

The definition of a NFP entity is currently included in three separate Standards: AASB 102, AASB 116 and AASB 136. However, none of these is a very obvious or logical location for the definition. To revise the definition and provide additional guidance, the AASB proposes that the definition is removed from those Standards and instead included in only one Standard, together with the associated implementation guidance.

The following options for implementing the proposed changes were considered:

(a) amendments to AASB 1057;

(b) amendments to AASB 1053; or

(c) 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 include NFP entities. Therefore, it is proposed that a NFP entity is defined in the Appendix to AASB 1057, and that the implementation guidance is added to AASB 1057 as another appendix, which would have mandatory status.

A revised definition of not-for-profit entity would also be incorporated into *The AASB's For-Profit Entity Standard-Setting Framework* (May 2018) and *The AASB's Not-for-Profit Entity Standard-Setting Framework* (May 2018).

Application date

It is proposed that the revised definition and implementation guidance would apply to annual periods beginning on or after a date yet to be determined, with earlier application permitted.

We need your feedback

Comments are invited on any of the proposals in this Exposure Draft by 9 September 2019. 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 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.

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.

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, or why not?

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

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?

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.

7 Do you agree that the implementation guidance should form an integral part of AASB 1057, ie have mandatory status? Please indicate your reasons.

General matters for comment

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

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

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

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

11 Whether the proposals are in the best interests of the Australian economy?

12 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

[Draft] Australian Accounting Standard AASB 2019-X *Amendments to Australian Accounting Standards – Not-for-Profit Entity Definition and Guidance* is set out in paragraphs 1 – 11. All the paragraphs have equal authority.

Preface

Standards amended by AASB 2019-X

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

Main features of this Standard

Main requirements

This [draft] Standard:

(a) deletes the current not-for-profit entity definition in AASB 102, AASB 116 and AASB 136;

(b) inserts a new definition of not-for-profit entity into AASB 1057, based on the New Zealand definition of public benefit entity in XRB Standard A1 *Application of the Accounting Standards Framework*; and

(c) adds implementation guidance to AASB 1057 to assist entities in applying the revised definition.

Application date

This [draft] Standard applies to annual periods beginning on or after … [date], with earlier application permitted.

[Draft] Accounting Standard AASB 2019-X

The Australian Accounting Standards Board makes Accounting Standard AASB 2019-X *Amendments to Australian Accounting Standards – Not-for-Profit Entity Definition and Guidance* under section 334 of the *Corporations Act 2001*.

Kris Peach

Dated … [date] Chair – AASB

[Draft] Accounting Standard AASB 2019-X
Amendments to Australian Accounting Standards – Not-for-Profit Entity Definition and Guidance

Objective

1 This Standard amends:

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

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

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

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

to replace the definition of a not-for-profit entity and add implementation guidance.

Application

2 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).

3 This Standard applies to annual periods beginning on or after … [date]. Earlier application of this Standard is permitted. When an entity applies this Standard to such an earlier period, it shall disclose that fact.

4 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)

5 Paragraph Aus6.1 in Appendix A 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 that it controls.**~~

…

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

6 Paragraph Aus6.1 in Appendix A is deleted.

Aus6.1 <u>[Deleted by the AASB]</u> ~~**The following term is also used in this Standard with the meaning 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 and each of the entities that it controls.**~~

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

7 Appendix D *Australian defined terms* is deleted. Appendix D included only the definition of a not-for-profit entity.

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

8 The appendix is relabelled as Appendix A and amended.

Appendix <u>A</u>

Defined terms

This appendix is an integral part of AASB 1057.

general purpose financial statements	…
<u>**not-for-profit entity**</u>	<u>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.</u>

…

9 Appendix B *Implementation guidance: When is an entity a not-for-profit entity?* is added as set out on pages 11–15 of this Standard.

10 *Illustrative examples*: *Determining whether an entity is a not-for-profit entity* are attached to accompany AASB 1057 as set out on pages 16–22 of this Standard.

Commencement of the legislative instrument

11 For legal purposes, this legislative instrument commences on … [date].

Appendix B
Implementation guidance: When is an entity a not-for-profit entity?

This appendix is an integral part of AASB 1057.

Purpose

1 The purpose of this implementation guidance is to assist an entity that prepares general purpose financial statements (GPFS) that comply with accounting standards issued by the Australian Accounting Standards Board (AASB) to determine whether 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 cash flows 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 FP entities are not defined. Rather, the term 'for-profit entity' encompasses all entities other than NFP entities. An entity must assess whether it is a NFP or FP entity by considering whether 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.

5 In many cases it will be obvious whether an entity meets the definition of a NFP entity. For example, most charities registered under the *Australian Charities and Not-for-profits Commission Act 2012* (Cth) 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, some public sector entities may operate under legislation that specifically requires them as their primary objective to provide goods or services for the benefit of the public and not to generate a financial return to equity holders.

6 In other cases it will not be immediately obvious that an entity is a NFP entity. Determining the primary objective of the entity (ie 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.

7 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.

8 The legal form of an entity is unlikely to be a conclusive factor in determining whether an entity is a NFP entity. NFP entities are constituted in many different forms, such as incorporated societies, trusts, statutory bodies and 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.

9 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.

10 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.

11 The assessment for classification as a NFP or FP entity is made at the entity level. As a result, the classification at the 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 has its own reporting obligations, the subsidiary assesses its own primary objective for financial 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 in the group would most likely determine the classification of the group.

Indicators

12 Paragraphs 13 to 37 discuss key indicators that aim to focus on the substance of an entity's purpose and that 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

13 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 Corporations Act 1989* (NSW) states in section 20E that the principal objectives of every statutory State-owned corporation (SOC) are:

(a) to be a successful business and, to this end:

(i) to operate at least as efficiently as any comparable business; and

(ii) to maximise the net worth of the State's investment in the SOC; and

(b) to exhibit a sense of social responsibility by having regard to the interests of the community in which it operates; and

(c) where its activities affect the environment, to conduct its operations in compliance with the principles of ecologically sustainable development contained in section 6(2) of the *Protection of Environment Administration Act 1991*; and

(d) to exhibit a sense of responsibility towards regional development and decentralisation in the way in which it operates.

14 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.

15 In the private sector, the meaning of charitable purpose is set out in the *Charities Act 2013* (Cth). In that Act, twelve charitable purposes are listed in section 12, including advancing health, advancing education, advancing social or public welfare, advancing religion, and advancing the natural environment, as well as a general category for other similar purposes 'beneficial to the general public'.

16 Many entities are established with multiple objectives. 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.

17 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.

18 In addition, some public sector entities may focus on internal administration rather than a stated objective of directly providing goods and services for community or social benefit. In this case, such an entity may still be a NFP entity if, upon consideration of the stated objectives and other indicators in this guidance, the entity's primary purpose is to facilitate the provision of goods and services for community or social benefit.

19 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 and efficiently.

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

20 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.

21 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, such surplus 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.

22 NFP entities may establish controlled entities or discrete business units that 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.[2]

23 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.

24 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, co-operatives may 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

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

26 Typically, the primary beneficiaries of a FP entity are its equity holders (including its parent, where the entity is controlled by another entity)[3] or other providers of economic resources to the entity (such as debt holders). These parties provide economic resources to the entity in exchange for an entitlement to financial returns.

27 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.

28 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 in this guidance).

Nature of equity interest

29 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

2 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.

3 As noted in paragraph 11, the assessment of the classification of an entity as a NFP or FP entity is made at the entity level. Where the entity is controlled by a NFP entity, how the NFP parent uses the financial returns provided by the entity to its parent is not relevant to the assessment of whether the entity should be classified as a FP or NFP entity.

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.

30 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 a 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

31 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.

32 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

33 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.

34 Many NFP entities are dependent on grants and donations. In addition, the sources of funding are usually from third parties (ie 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.

35 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.

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

Conflicting indicators

37 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

38 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.

39 Accounting for a change in classification depends on the applicable accounting requirements of the new classification and whether the entity already applies Australian Accounting Standards. For example, if an

entity changes classification but will continue to apply Australian Accounting Standards, any necessary accounting policy changes are subject to AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* and any specific transitional requirements in other Standards. If an entity changes classification and its most recent previous financial statements did not contain an explicit and unreserved statement that they complied with Australian Accounting Standards (whether Tier 1 or Tier 2) or IFRS Standards, the entity would need to apply the requirements in AASB 1053 *Application of Tiers of Australian Accounting Standards*.

Illustrative examples
Determining whether an entity is a not-for-profit entity

These illustrative examples accompany, but are not part of, AASB 1057. They are not intended to provide interpretative advice.

IE1 The following examples portray hypothetical situations. They are intended to illustrate application of the implementation guidance in Appendix B of AASB 1057 regarding when an entity is a not-for-profit entity. The examples are illustrative only and do not establish requirements. Although some aspects of the examples might be present in actual fact patterns, all relevant facts and circumstances of a particular fact pattern would need to be evaluated when applying the guidance.

IE2 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 a NFP entity. Rather, the examples illustrate indicators to be considered by preparers in reaching a conclusion regarding whether an entity is a NFP or FP 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 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 it is a NFP entity.

Example 1: Wholly owned State entity

Entity A is a water and wastewater service provider for certain regional communities, and is a wholly owned State company.

Stated objectives

Entity A is subject to State legislation applying to State-owned companies. The general objectives stated in the legislation are that each State-owned company is to perform its functions for the public benefit by:

- operating its business or pursuing its undertaking as efficiently as possible;
- maximising its contribution to the economy and well-being of the State;
- exhibiting a sense of social responsibility;
- operating in accordance with the principles of ecologically sustainable development where its activities affect the environment; and
- exhibiting a sense of responsibility towards regional development and decentralisation in the way in which it operates.

Any more specific objectives stated in other sources would need to be considered in determining whether this indicator points to Entity A being a FP or NFP entity. This could include stated objectives under:

- any other specific legislation relevant to Entity A;
- any Ministerial direction applicable to Entity A;
- any government policy framework or model under which Entity A is required to operate (including any performance targets); and
- any founding documents or constitution, including any Statement of Corporate Intent relating to Entity A.

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

The provision of water and wastewater services would result in community and social benefit for the particular regional communities receiving such services.

However, Entity A may operate under a government business model or policy framework requiring it to charge customers at commercial rates with the intention of generating a financial return for its equity holder (the State Government) or meeting financial and efficiency performance targets. This may indicate that Entity A is a FP entity.

Alternatively, Entity A may be required to charge customers at discounted rates, or to reinvest its surplus to facilitate regional development and infrastructure or otherwise in the public interest, and meet non-financial performance targets (such as the level of service to customers) rather than targeting a financial return to its equity holder. These factors may indicate that Entity A is a NFP entity.

Primary beneficiaries of the benefits

Although Entity A is a company, the primary beneficiaries may not be the State government.

If Entity A operates on a commercial basis for the purpose of providing a financial return to the State Government (ie the equity holder), then the primary beneficiary would be the entity's equity holder, which may indicate that Entity A is a FP entity.

However, if Entity A is required to reinvest any surplus to facilitate regional development and infrastructure or otherwise in the public interest, the primary beneficiaries would be the broader regional communities receiving the services, which may indicate that Entity A is a NFP entity.

Nature of equity interest

Entity A is a company. The equity interest is in the form of shares owned by the State Government. In the case of Entity A, the nature of the equity interest is clear. In addition, there may not be any 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 FP entity.

Conversely, if the company constitution (or other governing framework) 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 a NFP entity.

Purpose and use of assets

Entity A owns property, plant and equipment that it uses to provide water and wastewater services.

If Entity A holds those assets to operate or sell in order to generate a commercial financial return for the State government, this may indicate that Entity A is a FP entity.

However, if the property, plant and equipment is used primarily for providing water and wastewater services or enhancing infrastructure for the benefit of the regional communities it services, this may indicate that Entity A is a NFP entity.

Nature of funding

Entity A competes for funding from government and private sources.

If Entity A funds its activities primarily through charging commercial fees to customers for services rendered, this may indicate that Entity A is a FP entity.

Conversely, if funding is derived through a mix of government grants and discounted or subsidised fees, this may indicate that Entity A is a NFP entity.

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 its stated objective is to generate financial returns for its equity holder, this may indicate that the company is a FP entity.

Conversely, if the company's stated objective was to provide some form of community or social benefit (eg to provide employment for the homeless), this may indicate that it 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 out 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 Company 1 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 it 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 out at market rates and the primary beneficiary of the financial surpluses derived is the Trust (ie 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 is 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 are used to provide goods or services for community or social benefit (eg 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 sale and for hire 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 migrated 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 migrated 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 migrated to Australia from poverty-stricken countries.

As Entity B's objective is to provide high-quality education to immigrant children from poverty-stricken countries (ie 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 trust funds have been provided to Entity B for the benefit of immigrant children and not for the generation of a financial return to the trust beneficiaries. 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 is a NFP entity by considering the characteristics of the controlling entity in the group (which would most likely determine the classification of the group) and the characteristics 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 (ie 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 (eg 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), 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 may be established as a charitable trust with its constitution stating 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, Club AFC is established as an association and the constitution stated that Club AFC's objective is to maximise profits for the club or its members, 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 co-ordination 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 (eg to schools, other football clubs, or individuals) at normal market rates, with the aim of generating financial returns for the club or 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 may 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 the club or its members, this may indicate that Club AFC is a FP entity.

Primary beneficiaries of the benefits

Club AFC provides coaching and training 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 football as part of a keeping-active programme, providing some coaching at no cost for schools or providing free 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 the other indicators) to determine whether the entity is a NFP entity.

Nature of equity interest

Club AFC is a member-based entity and there are no specific 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 (or shareholders), 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 equipment used to record and 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 equipment, 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 socio-economic status (LSES) 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 LSES schools.

If Entity C's constitution states that its objective is to help children at LSES 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 LSES 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 LSES schools rather than distributing the profits to its shareholders, the primary beneficiaries are the children at LSES 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 are no entitlements to dividends;

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

(c) on Entity C ceasing to operate, any residual assets are 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 LSES 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 LSES schools, this may indicate that Entity C is a NFP entity.

If Entity C acquires or holds its assets primarily to operate or sell the assets in order 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 (eg dividends) or other economic resources, this may indicate that Entity C is a FP entity.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, AASB 2019-X Amendments to Australian Accounting Standards – Not-for-Profit Entity Definition and Guidance.

Introduction

BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board's considerations in reaching the conclusions in this Standard. It sets out the reasons why the Board developed the Standard, the approach taken to developing the Standard and the key decisions made. In making decisions, individual Board members gave greater weight to some factors than to others.

Reasons for issuing this Standard

BC2 A not-for-profit (NFP) entity is currently defined in Australian Accounting Standards as an entity whose principal objective is not the generation of profit. The classification of an entity as a for-profit (FP) entity or a NFP entity is important because the application of the 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.

BC3 The distinction between a FP entity and a NFP entity would become even more significant if the Board develops a separate NFP entity financial reporting framework with simplified recognition and measurement requirements and different reporting tiers for NFP entities.

BC4 As part of the consultation undertaken in relation to revising the Board's standard-setting frameworks for FP and NFP entities in 2017, the Board asked for specific feedback regarding the definition of a NFP entity, and whether there was sufficient guidance on how to distinguish entities as FP entities and NFP entities.

BC5 The majority of respondents supported retaining the term 'not-for-profit entity', but requested more guidance in determining whether an entity is a FP or NFP entity under the Standards.

The implementation guidance

BC6 A majority of respondents supported the Board monitoring and working with the New Zealand Accounting Standards Board on its project to update the definition of a public benefit entity (PBE), which is the New Zealand term for a not-for-profit entity. 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 entity. Contrary to the current definition of a NFP entity in Australian Accounting Standards, it would provide a positive statement of what a NFP entity is, rather than what it is not.

BC7 In December 2018, the New Zealand External Reporting Board (XRB) issued the XRB Exposure Draft *2018 Amendments to XRB A1 Appendix A*, which proposed amendments to Appendix A of XRB Standard A1 *Application of the Accounting Standards Framework*. Appendix A provides guidance to assist an entity in determining whether it is a PBE or FP entity. The New Zealand amendments have now been finalised as proposed in the XRB ED through the issue of the XRB Standard *2019 Amendments to XRB A1 Appendix A* (May 2019).

BC8 The Board decided in February 2019 that the XRB definition of PBE and the associated draft revised guidance would generally be appropriate for use under the Australian standard-setting framework, subject to certain amendments to adapt it for the Australian context. This Exposure Draft is based on that New Zealand work.

BC9 In adapting the XRB material for this ED, the Board decided to replace the NZ example 1 of Crown Research Institutes with an Australian hypothetical example of a wholly owned State entity. In addition, the Board added a paragraph (paragraph 18) to the main guidance to address the classification of public sector entities that are focussed on internal administration, given the likelihood of differing views.

Changing classification

BC10 The guidance addresses the potential accounting consequences for an entity changing its classification from a NFP entity to a FP entity, or vice versa. Where an entity has complied previously with Australian Accounting Standards, accounting policies will need to change where there are differences between the requirements for

FP and NFP entities, as relevant to the entity. Changes in accounting policies are required to be accounted for in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, if an entity has not fully complied with the Standards in its most recent previous financial statements, the entity should apply the requirements set out in AASB 1053 *Application of Tiers of Australian Accounting Standards* for either the first-time adoption of the Standards or the reapplication of the Standards, as relevant. This approach will ensure that the change in accounting policies is made appropriately.

BC11 No specific requirements are considered necessary for the first-time application of this guidance, when this results in a change in the classification of an entity. The approach to a classification change under the ongoing application of this guidance is equally applicable to the first-time case.