



BUSINESS COUNCIL
OF CO-OPERATIVES AND MUTUALS

ED 291 Not-for-profit entity and guidance
Submission to the Australian Accounting Standards Board

October 2019

The Business Council of Co-operatives and Mutuals (BCCM) welcomes the opportunity to make a submission to the Australian Accounting Standards Board (AASB)'s consultation on ED 291 Not-for-profit entity and guidance.

The BCCM is the national peak body for co-operative and mutual enterprises (CMEs) in Australia. It is a member driven and funded organisation representing CMEs in all industries.

There are more than 2,000 CMEs in Australia. The top 100 CMEs have a combined turnover of more than \$30bn (National Mutual Economy Report 2018).

The 2015 Senate Economics References Committee inquiry into the sector highlighted both the important contributions the sector makes to Australian economic and community life and the need for greater inclusion of CMEs in policy development. The BCCM notes the leadership of the AASB in responding to the findings of that inquiry through, among other things, the publication of the [AASB Staff FAQs on Co-operative and Mutual Enterprises](#).

In preparing this submission, the BCCM consulted with members from the co-operative and mutual sector and the BCCM Accounting Working Group.

General comments

We refer to our January 2018 submission to the AASB's consultation on the Standard-setting Frameworks for For-Profit Entities and Not-For-Profit Entities (**attached**). In that submission, we noted concerns with how CMEs can fit within frameworks based on the for-profit/not-for-profit binary:

The frameworks as set out in the draft divide all entities to which accounting standards might apply into two types, namely 'For-Profit'(FP) and 'Not-for-Profit'(NFP)...we [BCCM] do not believe that the current definition of FP/NFP adequately covers all entity types – particularly CMEs.

For reasons outlined in our responses to relevant consultation questions, the BCCM is unable to assess whether the proposed not-for-profit definition in ED 291 will increase simplicity, consistency or comparability for CMEs.

The BCCM and our members support the AASB's efforts to provide greater clarity and simplicity to stakeholders regarding the definition of a not-for-profit entity. However, we are conscious of potential negative implications for the enterprises within our membership. We urge the AASB to continue to be mindful of the potential impacts for CMEs of the proposed not-for-profit entity definition and guidance; to continue to work with CMEs to develop a better understanding of potential impacts; and to consider the specific considerations BCCM have listed below for further investigation.

1. Do you agree that the current definition of a 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?

Some CMEs have noted potential advantages to streamlining the definition of a not-for-profit entity in the Australian Accounting Standards (AAS).

Some CMEs assessed the proposed definition and guidance as more clear than the current definition.

However, the BCCM urges the AASB to consider, and provide clarification on a number of matters, including:

- The impact of the proposed definition of not-for-profit on common law concepts of mutuality, profit and surplus;
- Whether co-operatives and mutuals that are within the proposed definition of a not-for-profit entity can continue to report to the International Financial Reporting Standards (IFRS) level. Many co-operatives and mutuals operate in markets with for-profit competitors and wish to prepare comparable financial reports;
- Further to the above matter, the likely interaction between the proposed not-for-profit definition and IFRS 17. The BCCM understands that with the implementation of IFRS 17, all private health insurers will be required to report under IFRS, including not-for-profit mutual insurers; and
- The implications of the proposed definition for not-for-profit mutuals that elect to issue Mutual Capital Instruments and make distributions on those instruments. The BCCM requests the AASB consult with ASIC and APRA on this matter.

Community First Credit Union, owned by 68,000 members and with branches across Sydney, the Central Coast and Newcastle, does not support the proposed definitions of not-for-profit and for-profit entities and suggest that a third category that accommodates mutual entities be introduced.

2. Do you agree with the proposed implementation guidance and illustrative examples?

If there is a change to the not-for-profit definition, further guidance is required for determining the substance of an entity's primary objectives when the assessment shows a balance of not-for-profit and for-profit indicators.

The CME sector would like to see further guidance and illustrative examples for co-operatives and mutuals, including for mutual Authorised Deposit-taking Institutions. In particular, further guidance in relation to what constitutes social or community benefits (nature of the benefits), primary beneficiaries of the benefits, and the nature of equity interest are important for CMEs.

Community First Credit Union noted that in a credit union or mutual bank, the resource providers are the customers, and this should be considered in the guidance and illustrative examples.

BCCM offers to assist the AASB to identify enterprises among our membership in order to develop diverse illustrative examples to explore these matters in depth and to understand the implications for CMEs with greater certainty.

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?

If there is a change to the not-for-profit definition, further guidance is required for mixed groups such as where a parent entity is not-for-profit and subsidiaries are assessed as for-profit entities.

The BCCM stands ready to provide further information to the AASB should that be required.

Melina Morrison
Chief Executive Officer

Attachments

- A. BCCM Submission to the AASB consultation on Standard-setting Frameworks for For-Profit Entities and Not-For-Profit Entities

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Attachment

Kris Peach
Chair
Australian Accounting Standards Board
Level 14, Podium level
530 Collins St.
Melbourne
Victoria 3000
Via online portal:

17 January 2018

Dear Ms Peach,

The AASB's Standard-Setting Frameworks for For-Profit Entities and Not-for-Profit Entities

Thank you for the opportunity to comment on your draft Standard Setting Frameworks (the Frameworks).

We would like to commend you at the outset on the thorough, generally comprehensive and readable nature of the Frameworks consistent with the high standards of analysis and reasoning which we have come to expect from your Board. Nevertheless, the BCCM believes that there are some issues with the binary structure of the Frameworks (i.e. focused on whether an entity is For-profit or Not-for-profit), particularly in their application to co-operative and mutual enterprises. This is the focus of our comments below.

About the Business Council of Co-operatives and Mutuals

The BCCM is the peak body for Australian co-operatives, mutuals and member-owned businesses. The BCCM represents a diverse range of businesses operating in sectors including agriculture, finance and banking, insurance, motoring services, health services, aged care, disability employment, education, indigenous services, social housing and retail.

The BCCM advocates for recognition of the sector and for measures that create a level playing field between co-operatives and other businesses, including implementation of the recommendations of the Senate Economics References Committee report into co-operative, mutual and member-owned firms.

About Co-operative and Mutual Enterprises (CMEs)

Co-operative and mutual enterprises (CMEs) are a significant contributor to the Australian economy. 8 in 10 Australians are members of at least one CME, with many being members of multiple entities (there are 28 million memberships). Total value added of the CME sector is \$140 billion - 8.3% of GDP, and, excluding mutual superfunds, total revenue of the top 100 CMEs is \$30 billion.¹ The sector provides core business support for over 174,000 businesses.

The distinguishing feature of all CMEs, regardless of what legal form they use, is that they are owned by their members and operate for member benefit. Member benefit can mean a wider range of social or non-financial benefits as distinct from the financial returns enjoyed by an investor. Membership is tied to contributing to or making use of the CME; this ensures the CME is made up of people who share its common purpose.

The vast majority of CMEs are incorporated and regulated under one of two legislative regimes: the State/Territory-based Co-operatives National Law (the CNL)² or the *Corporations Act 2001* (Cth). Whether a company under the *Corporations Act* is a co-operative or mutual will depend on its constitution.

1. A significant reservation

There is one aspect of the proposed frameworks which does concern us, not just because it does not align with current circumstances but because of the implications it has for future developments.

The frameworks as set out in the draft divide all entities to which accounting standards might apply into two types, namely 'For-Profit'(FP) and 'Not-for-Profit'(NFP). In the absence of any reference in the draft to other types of entity for which further frameworks may be developed in due course, we are assuming that the frameworks will result in standards being developed for only those two types of entity as defined. As explained further below we do not believe that the current definition of FP/NFP adequately covers all entity types – particularly CMEs. This raises the question, 'would an alternative definition allow all entities to be adequately covered by a binary definition or are there more than two types of entity which need standard setting frameworks?'

Specific mentions are made in the referenced research report to listed companies, large proprietary companies, government departments (3 levels) and charities, each of which can be easily and satisfactorily allocated to one or other of the proposed classifications. The research also refers to 'others' but provides no guidance as to why they are categorised as NFP.

In re-assessing whether the FP/NFP classification is adequate for all future standard

¹ Business Council of Co-operatives and Mutuals, *National Mutual Economy Report 2017*, <http://bccm.coop/wp/wp-content/uploads/2017/11/BCCM-2017-NME-Report.pdf>, 20.

² CNL, adopted in all States and Territories except Queensland. Western Australia has adopted consistent legislation.

setting processes, we request that further consideration be given to (inter alia) the following factors.

2. CMEs and the Definition of For-Profit and Not-for-Profit Entities

The draft Frameworks divide all entities to which accounting standards might apply into two types, namely 'For-Profit' (FP) and 'Not-for-Profit' (NFP). The definition of FPs as "entities whose principle objective is the generation of profit" is too narrow and would inadvertently exclude a substantial proportion of the CME sector and place them in the NFP category (effectively defined as all other enterprises).

There are a wide variety of enterprises that do not fit easily within the definitions of FP and NFP entities. Some notable examples, many of them CMEs, include:

- incorporated associations with more than half a million members each and running substantial commercial enterprises;
- co-operatives established solely to operate sporting facilities (eg. Ski Clubs) for (in practice) the self-interest of a very limited membership;
- co-operatives that provide essential social services to often disadvantaged communities;
- large farmer co-operatives established to ensure sustainable supply chains (marketing, processing) for members while also distributing surpluses to those members.
- a large non-distributing and charitable co-operative established to develop the grain industry including through the delivery of efficient commodity transport, processing and marketing services for the benefit of members and the community.
- a company limited by shares and guarantee established to provide trustworthy services to its members which has never paid a dividend to its members but is a listed company;
- entities registered as charities which operate business enterprises of various sizes including the category of significant to the Australian economy.

The overarching characteristic of CMEs is that they are entities run to benefit members. Members of a CME must be "active members", in the sense that they use, support or maintain a relationship with the CME in order that the CME can carry on its primary activity. Examples of active relationships include the employee, customer or supplier relationship. Consequently they differ from what is generally thought of as a 'typical' charity (the clearest case of an NFP entity) or a 'typical' profit-making entity, such as a listed company (the clearest case of a FP entity).

Charities and CMEs

A charity is an entity with a charitable purpose that works to benefit the general public or a sufficient section of the general public.³ The 'general public' are typically understood to be external to the charity.

CME entities, however, work to benefit members, which has often raised issues for charitable CMEs, given that members are not external to the charity. Nevertheless, charitable status has been extended to CMEs where its class of members is deemed to be identifiable with a sufficient section of the general public or where they serve both their members and non-members in some way. A recent example is the Supporting Independent Living Co-operative, which works for the benefit of its members, who are themselves co-operatives that provide housing services for NDIS recipients.

Profit-making entities and CMEs

A profit-making entity is an entity that works to generate a profit via commercial trading. Profit is the difference between revenue and expenses, with a 'typical' FP entity being a listed entity that maximises profit for the benefit of external shareholders.

Once again, the fact that CMEs work to benefit members with an active relationship with the entity presents difficulties. A CME that generates income via commercial trading will work to generate a profit, but it will not necessarily seek to maximise accounting profit. Where a CME's members are its customers, it may forego some accounting profit to provide cheaper goods or services to its members (for example a member-owned bank or a motoring association); or where its members are suppliers it may seek to pay higher prices for supplies also at the expense of some accounting profit (for example agricultural co-operatives).

This does not mean that a CME of this kind is not a FP entity; it only means that it chooses to distribute its income in ways other than via dividends only. This is a result of CME members being active members (i.e. users of or contributors to the substantive trading activities of the entity) and not simply investors with only a financial interest in the entity.

3. Implications of the proposed FP/NFP definitions

Mutual Companies under the Corporations Act

The Government recently accepted and initiated the implementation of all the recommendations of the Hammond review into the recommendations of the Senate inquiry into Cooperatives [sic], mutuals and member-owned firms regarding capital instruments for mutuals.

³ *Charities Act 2013* (Cth), s 6(1).

The Australian Treasurer has indicated that he anticipates that legislation will be introduced in the second half of this year (2018) to amend the *Corporations Act 2001* to define a mutual company and introduce a mutual capital instrument. Broadly, a company will be a mutual company when it has a democratic governance structure and has restrictions on its ability to make distributions to members.

Under the proposed Frameworks a registered charity which utilises volunteers to collect donations for distribution to those in need will be placed in the same category as a mutual company. The latter may be a multi-national enterprise which competes with listed companies in the provision of services and, once it has access to mutual capital instruments, pays dividends out of profits to holders of listed equity interests in the mutual.

It would be entirely inappropriate that mutual companies with access to equity instruments would be required to use NFP accounting standards. This would undermine the government objective of increasing access to capital for mutuals given that it would make it harder for investors to form decisions on whether to provide capital.

ATO and ASIC definitions

It is concerning that the 'elevation' of the definition of NFP from certain accounting standards to its own standard-setting Frameworks may inadvertently exacerbate an existing inconsistency in terminology.

Both the ATO (in relation to the eligibility criteria for certain tax exemptions) and ASIC (in relation to eligibility for exemption from certain disclosure requirements as they apply to certain mutual enterprises) define a not-for-profit entity as being one that is *not carried on for the individual gain of its members*.⁴ The AASB definition, by contrast, focuses on whether the *generation of profits is the dominant objective of the entity*.

User acceptance of further developments in accounting standards predicated on a thoroughly constructed framework might be undermined by confusion as to the underlying definitions of FP and NFP.

4. Proposed solutions

We note that the requirements of the *Australian Securities and Investments Commission Act 2001* do not specify the types of entity for which standards must be developed but do specify that standards are to be developed for each different type. This could be achieved in three ways:

⁴ *Income Tax Act 1986* Section 3; ASIC *Regulatory Guide 147 Mutuality: Financial Institutions* Paragraph RG147.48.

Proposed solution one

Primarily we generally favour the simplicity, consistency and inherent comparability that is achieved by requiring all entities to abide by the same standards developed as part of a single framework. We therefore suggest that only one framework is needed under which standards are set for all entities with specific exceptions/variations included where necessary for specific types of entities clearly identified in legislation.

Proposed solution two

Alternatively the singular objective test in the NP/NFP definition should be changed to a multiple objectives test:

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

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

This definition would capture as FPs entities such as CMEs that generate income via commercial trading but may not maximise accounting profit as their primary objective. It is unlikely that financial reports based on NFP standards would meet the needs of CME members let alone the full range of their stakeholders including regulators, analysts and investors.

Proposed solution three

If neither of the above approaches is adequate for standard setting purposes, we suggest that five frameworks are established covering listed/significant commercial entities, other commercial entities, non-commercial entities, ACNC registered charities and government departments. Those classifications would in turn assist entities to ensure that their governing documents are sufficiently descriptive for framework classification purposes to allow for easy identification of the category they fall into (for standard setting and also many other purposes).

5. Further clarification

If you require any clarification of any aspect of our input to this important initiative on the part of your Board aimed at enhancing the quality of financial reporting in Australia, please do not hesitate to contact me. We would be happy to meet with you, if appropriate, to answer any questions you may have in relation to this submission and/or financial reporting by CMEs in general.

In conclusion may we re-iterate our appreciation of the opportunity to be consulted on a matter which will have substantial implications for our members who play a vital role in

the Australian economy and community.

Yours sincerely



Melina Morrison
Chief Executive Officer