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Kris Peach  
Chairman and CEO  
Australian Accounting Standards Board  
PO Box 204  
Collins Street West VICTORIA 8007

Dear Kris

**Request for Comment on ED 291 "Not-for-Profit Entity Definition and Guidance"**

Ernst & Young Australia is pleased to comment on the above Exposure Draft. We welcome the opportunity to contribute to the future of financial reporting in Australia.

We support the AASB's proposals to retain the term "not-for-profit entity" (NFP entity) but to replace the definition of NFP entity with the New Zealand definition of public benefit entity (PBE) and provide detailed implementation guidance for its application. The lack of detailed implementation guidance has presented challenges over the years in classifying an entity as a NFP entity or for-profit entity (FP entity). The existence of a comprehensive definition and guidance will ensure greater consistency in classification across entities. In addition, the appropriate classification of an entity is not only important because different recognition, measurement and presentation and disclosure requirements can apply, but will also become even more important if the AASB develops a separate financial reporting framework for NFP entities.

Our detailed responses to the specific questions raised in the Exposure Draft are provided in Appendix A to this letter. Additional feedback on the proposals is provided in Appendix B.

We would be pleased to discuss our comments further with either yourself or members of your staff. If you wish to do so, please contact Melissa Sim on (02) 9276 9965 or Georgina Dellaportas on (03) 9288 8621.

Yours sincerely

A handwritten signature in black ink that reads "Ernst + Young". The signature is written in a cursive, flowing style.

Ernst & Young

## Appendix A

### Specific matters for comment

***Q1 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?***

We agree that the current definition of NFP entity should be replaced with the NZ definition of PBE. The NZ definition is comprehensive and detailed and places more focus on the nature and purpose of the entity, as opposed to the current definition which only focuses on whether the entity's primary objective is not to make a profit.

***Q2 Do you agree with the proposed implementation guidance and illustrative examples?***

Overall, we agree with the proposed implementation guidance and illustrative examples. Recommended improvements to the implementation guidance are provided in Appendix B below.

***Q3 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?***

In determining the classification of a group, we believe it is necessary to consider the characteristics of the group which includes the characteristics of the controlling entity. As the group includes the controlling entity, it is the characteristics of the group that should be considered in determining the classification of the group. There is no need to consider the parent's characteristics in addition to the group.

However, we do not agree that the classification of the controlling entity would most likely determine the classification of the group in all circumstances. For example, the parent entity may only be a holding company with no significant operations, in which case the characteristics of the group are relevant in determining the appropriate classification of the group.

***Q4 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?***

We disagree with the proposed guidance that addresses the potential accounting consequences for an entity changing its classification from a NFP entity to a FP entity, or vice versa.

We believe that a change in accounting policies resulting from a change in status should be accounted for prospectively, rather than retrospectively. This is on the basis that a change in status of the entity should not result in an entity being required to report previous



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financial information differently, when those conditions didn't previously exist. This is similar to change in tax status which is only ever accounted for prospectively.

The AASB should also consider the differences between NFP and FP accounting policies, including consolidation, and the consequences of ED 297 and whether additional guidance is required in the Australian context for entities when they change from NFP to FP. For example, the NFP requirements under AASB 116 *Property, Plant and Equipment* with respect to the recognition of revaluations may be difficult to unwind in a FP environment.

***Q5 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?***

We believe that transitional relief for the first-time adoption of this guidance is required. Application of accounting policies on a fully retrospective basis per AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* can be very onerous for entities affected by these proposals. It is therefore recommended that the Board provide transitional relief similar to recently issued standards including AASB 15, AASB 16 and AASB 1059 to allow entities the choice to apply the guidance using a fully retrospective or a modified retrospective approach, whereby new policies are applied at the beginning of the period of initial application. Refer also comments made at Q4 regarding potential need for additional guidance.

***Q6 Do you agree that the definition and associated guidance should be included in AASB 1057 Application of Australian Accounting Standards?***

We agree that the definition and associated guidance should be included in AASB 1057 given that AASB 1057 specifies the types of entities and financial statements to which Australian Accounting Standards apply, which includes NFP entities. We agree that the definition should be included in the Appendix to AASB 1057 and that the implementation guidance is added as a separate additional appendix.

***Q7 Do you agree that the implementation guidance should form an integral part of AASB 1057, ie have mandatory status?***

We agree that the implementation guidance should form an integral part of AASB 1057 and have mandatory status.

## **General matters for comment**

***Q8 Whether "The AASB's Not-for-Profit Entity Standard-Setting Framework" has been applied appropriately in developing the proposals in this Exposure Draft?***

We believe that the "The AASB's Not-for-Profit Entity Standard-Setting Framework" has been applied appropriately in developing the proposals in this Exposure Draft.



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***Q9 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?***

We are not aware of any such issues however we believe that the respective Treasuries of each government are better placed to answer this question.

***Q10 Whether, overall, the proposals would result in financial statements that would be useful to users?***

We believe that the proposals would result in financial statements that would be useful to users. As noted in our cover letter, the lack of detailed implementation guidance has presented challenges over the years in distinguishing an NFP entity from a FP entity and the use of a more comprehensive definition and guidance will ensure greater consistency in classification across entities, which is important given the different recognition, measurement, presentation and disclosure requirements which can apply.

***Q11 Whether the proposals are in the best interests of the Australian economy?***

Yes, the proposals are in the best interests of the Australian economy.

***Q12 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.***

We provide no comment on this question. Impacted entities would be better placed to answer this question.

## Appendix B

### Other matters for the Board's attention

Implementation Guidance	
Paragraph 6	<p>Second sentence, we recommend adding:</p> <p>"or where there are equally competing objectives"</p>
Paragraph 7	<p>Last sentence below is not required and should be removed since both parts of the definition must be assessed (and met) for an entity to be classified as a NFP entity.</p> <p>"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. <del>Assessing one of the parts alone is unlikely to be sufficient in determining whether an entity is a NFP or FP entity.</del>"</p>
Para 9	<p>Para 9 is trying to articulate that a group of people can also be a slice of the community. However, we are unclear of the relevance of the last sentence, as any entity, whether FP or NFP may provide indirect benefits to society as a whole.</p> <p>"However, society as a whole may also benefit indirectly through a healthier population and through the provision of organised activities for its youth."</p> <p>We therefore recommend it be removed.</p>
Paragraph 11	<p>The last sentence should be deleted based on our specific comments above.</p> <p><del>"The classification of the controlling entity in the group would most likely determine the classification of the group"</del>.</p>
Paragraph 13	<p>The example should be made more succinct and generic (in line with providing guidance) with the more detailed example provided in the Implementation examples IE section. We therefore recommend that if retained, this example is moved to the IE section and the text below is deleted as follows:</p> <p>"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. <del>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:</del></p> <p><del>(a) to be a successful business and, to this end:</del></p> <p><del>(i) to operate at least as efficiently as any comparable business; and</del></p> <p><del>(ii) to maximise the net worth of the State's investment in the SOC; and</del></p> <p><del>(b) to exhibit a sense of social responsibility by having regard to the interests of the community in which it operates; and</del></p> <p><del>(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</del></p>



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	<del>(d) to exhibit a sense of responsibility towards regional development and decentralisation in the way in which it operates."</del>
Paragraph 14	<p>We recommend amendments are made to this paragraph to expand the other sources which should be considered.</p> <p><u>"In addition, any more specific objectives stated in other sources would need to be considered in determining whether this indicator points to an entity being a FP or NFP entity. This includes the founding documents of an entity which may also specify the objective of an entity in terms of the nature of the benefits the entity provides.</u></p> <p>This could include stated objectives under:</p> <ul style="list-style-type: none"> <li>• any other specific legislation relevant to the entity;</li> <li>• any Ministerial direction applicable to the entity;</li> <li>• any government policy framework or model under which the entity is required to operate (including any performance targets); and</li> <li>• any founding documents or constitution, including any Statement of Corporate Intent relating to the entity."</li> </ul>
Para 19	<p>On the basis that the reference to generating an adequate rate of return may be considered to imply financial returns to equity holders, it is recommended that the paragraph be amended as follows (inserted text is underlined):</p> <p><u>"The founding documents may require an entity to be financially viable or to generate an adequate rate of return. However, being financially viable or generating an adequate rate of return is not in themselves 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. Similarly, NFP entities may be required to generate an adequate rate of return for the purpose of being able to financially support its objective of providing goods or services to the community or members rather than for the objective of providing returns to equity holders."</u></p>
Paragraph 21	<p>Recommend adding to the second sentence the underlined text below:</p> <p><u>"They exist with the primary objective..."</u></p>
Paragraph 22	<p>It is recommended that para 22 be moved to after para 24.</p> <p>Also, it is recommended that para 22 be amended as follows:</p> <p><u>"NFP entities may establish controlled entities or discrete business units that operate to generate a financial surplus that commercial or market return which 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."</u></p>
Paragraph 23	<p>It is recommended that the sentence below is amended as follows as not all benefits of FP entities are financial:</p> <p><u>"On the other hand, the benefits provided by FP entities are primarily financial in nature..."</u></p>



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Paragraph 24	Suggest replacing word “dividends” in first sentence with word “distributions”, as financial returns to equity holders can be in a form other than dividends, eg trust distributions.
<b>Illustrative Examples</b>	
Example 1	<p>Recommend changing all references to “company” to “corporation”.</p> <p><b>Primary beneficiaries</b></p> <p>Amend sentence as follows “Although Entity A is a State-owned corporation, the primary beneficiaries may not be the State government.”</p> <p>Amend the third paragraph to add reference to discounted goods being provided to customers which is also a benefit provided to beneficiaries.</p> <p>“However, if Entity A is required to <u>provide services at discounted rates or reinvest any surplus to facilitate regional development and infrastructure or otherwise in the public interest</u>, the primary beneficiaries would be the broader regional communities receiving the services, which may indicate that Entity A is a NFP entity.”</p> <p><b>Nature of funding</b></p> <p>Amend as follows to add equity funding from government per para 36 of the guidance:</p> <p>“If Entity A funds its activities primarily through charging commercial fees to customers for services rendered <u>or through equity funding from the State government</u>, this may indicate that Entity A is a FP entity.”</p>
Example 2	<p>At end of first paragraph add the words “<u>...through a separate entity (Company 1).</u>”</p> <p><b>Nature of equity interest</b></p> <p>Amend third paragraph as follows:</p> <p>“However, if the trust deed provides that in the event Company 1 ceases trading any residual assets must be <u>transferred to the Trust or donated to a charity that fulfils the same or a very similar charitable purpose to that of the Trust</u>, then this may indicate that Company 1 is a NFP entity.</p> <p><b>Purpose and use of assets</b></p> <p>Replace reference to “Trust” in second line with “Company”.</p>
Example 3	<p><b>Nature of benefits</b></p> <p>Remove the text as a shown in last sentence of last paragraph. While the characteristics of the controlling entity should be taken into account, they should not necessarily determine the classification of the group as NFP or FP entity.</p> <p>“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 <del>(which would most likely determine the classification of the group)</del> and the characteristics of the group.”</p>



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Example 4	<p><b>Primary beneficiaries of the benefits</b></p> <p>Amend third paragraph as follows for consistency:</p> <p><del>“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. this may indicate that Club AFC is a FP entity.”</del></p>
Example 5	<p>Recommend deleting first paragraph in italics as this is the basic premise of this guidance and examples.</p> <p><b>Nature of benefits</b></p> <p>Recommend swapping first and second paragraphs to discuss NFP indicator first before FP indicators as per other examples previously.</p> <p><b>Primary beneficiaries</b></p> <p>Same comment as above.</p>