



ACT
Government

Chief Minister, Treasury and
Economic Development

Ms Kris Peach
The Chair
Australian Accounting Standards Board
PO Box 204
Collins Street West
Victoria 8007

Dear Ms Peach

ED 291 – *Not-for-Profit Entity Definition and Guidance*

The Heads of Treasury Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to provide comments to the Australian Accounting Standards Board (AASB) on the Exposure Draft (ED 291) *Not-for-Profit Entity Definition and Guidance*.

The majority of HoTARAC members broadly agree with the definition but recommend clarifying some points to remove ambiguity and avoid inconsistent practices arising.

The attachment to this letter sets out HoTARAC's comments on the specific and general matters. If you have any queries regarding HoTARAC's comments, please contact Peter Gibson from the Australian Government Department of Finance on (02) 6215 3551 or via email at Peter.Gibson@finance.gov.au.

Yours sincerely

David Nicol
CHAIR

Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC)

16 September 2019

Matters for Comment

Specific Matters for Comment

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

HoTARAC has mixed views on the definition.

HoTARAC Majority View

The majority of HoTARAC members broadly agreed with the proposed definition but recommend clarifying some points. As acknowledged in paragraph 6 of Appendix B, it is not always obvious what the primary objective of an entity is. This is of particular relevance in the public sector where governments are unlikely to fund an activity without some community or social benefit. In this respect HoTARAC regards the guidance of paragraph 21 of Appendix B on whether the surplus is returned to owners as critical.

Paragraph 8 of Appendix B notes that the legal form of an entity is unlikely to be conclusive and a wide range of structures are used. In considering this, HoTARAC suggests replacing the term 'equity' and 'equity holders' with 'owners' contribution' and 'owners' respectively. Whilst governments may have formal equity agreements with some of its entities, control is often established through other means, such as enabling legislation. HoTARAC notes that the Reserve Bank of Australia's dividend policy is established through legislative means¹, rather than an equity agreement.

HoTARAC's proposed definition is:

'An entity whose primary objective is to provide goods or services for community or social benefit and where any equity owner's contribution has been provided with a view to supporting that primary objective rather than for a financial return to equity holders owners.'

An alternative would be to add equity and equity holders to the list of defined terms and explicitly define this to include a broad range of arrangements. HoTARAC notes that the example of paragraph 30 of Appendix B appears to anticipate equity holders encompassing arrangements outside a formal equity instrument.

Whatever approach is taken will need to be considered in the guidance paragraphs.

HoTARAC also recommends that the guidance states that the objective of achieving a financial return is evaluated over the long-term, so there is limited possibility of entities transitioning back and forth between 'for profit' and 'not for profit' classifications.

HoTARAC Minority View

A HoTARAC minority disagree on the return of the surplus to owners being key leg to the definition as this criteria is more suited to the private not for profit sector and not particularly well suited to the nuance in the public sector. This is owing to Competitive Neutrality principles which are not a feature of the private not for profit sector.

¹ <https://www.rba.gov.au/publications/annual-reports/rba/2018/earnings-distribution-and-capital.html>

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

2.1 Use of 'commercial returns'

HoTARAC Majority View

The HoTARAC majority suggests that paragraph 23 of Appendix B does not refer to 'commercial' or 'market' returns. Instead HoTARAC suggests paragraph 23 refers to maximising returns, subject to the public service constraints the entity operates under or simply to 'positive' returns. The majority view is that if an entity is capable of generating a commercial return, the only instance where government would be regularly involved would be in cases of market failure. Governments establish a range of entities for public policy goals and the type of funding is determined by the nature of the project and market, rather than the need to generate a commercial return. HoTARAC refers the AASB to page 4-13 of the Budget Paper 1 of the 2018-19 Budget² which refers to a 'direct return' on equity, rather than a commercial return. Such an approach would also be more consistent with GFS.

Other examples of 'for profit' entities that generate positive, rather than fully commercial returns are the Commonwealth's NBN Co and Australia Post.

Accordingly, paragraph 23 could be amended as follows:

"The benefits provided by FP entities are financial in nature. Most FP entities aim to generate a ~~commercial or market~~ **positive return and be financially viable in the long term**—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.

HoTARAC Minority View

A HoTARAC minority favour retaining 'commercial terms'.

2.2 Description of 'equity holder'

HoTARAC suggests that paragraph 29 of Appendix B be less prescriptive in describing an equity holder. As noted above, government control is often established legislatively.

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

HoTARAC also suggests adding an example for the central bank, the Reserve Bank of Australia (RBA). The stated objectives of the RBA in section 10(2) of the Reserve Bank Act:

- the stability of the currency of Australia;
- the maintenance of full employment in Australia; and
- the economic prosperity and welfare of the people of Australia.

Appears social in nature, but RBA operates and reports on a 'for profit' basis and pays dividends back to Government

² <https://archive.budget.gov.au/2018-19/bp1/bp1.pdf>

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?

HoTARAC agrees.

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?

HoTARAC agrees.

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?

HoTARAC recommends that entities are not required to prepare comparatives, with the impact of the change taken to accumulated results. HoTARAC notes that changes from NFP to FP financial reporting and vice versa are unlikely to result in significant changes in financial aggregates unless there are material changes in impairment charges or from the application of 'Aus' paragraphs in AASB 102 *Inventories*. Consequently, the cost of applying comparatives would outweigh the benefits.

HoTARAC further recommends a particular transition requirement. Entities reclassified from NFP to FP entities should not have to retrospectively recalculate their asset revaluation reserve on an asset by asset basis under AASB 116 *Property, Plant and Equipment*. Entities who have reported on an NFP basis will not always have recorded their revaluation increments for each asset. Consequently, reconstructing the revaluation reserve will be time-consuming with little benefit to users as the information relates to past periods.

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.

HoTARAC agrees.

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

HoTARAC agrees so a consistent approach is adopted to classification.

General Matters for Comment

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

A HoTARAC minority observe that the AASB appears to have gone beyond the request by constituents (framework paragraph 24(d)) for more guidance concerning determination of NFP status, by also altering the definition.

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?

HoTARAC is not aware of any regulatory issues.

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

The HoTARAC majority is of the view that by refining the definition of a not-for-profit entity to more closely match the nature of the reporting entity, financial statement usefulness to users will be enhanced.

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

No comment.

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.

HoTARAC would regard the cost of moving from 'for profit' to 'not for profit' reporting as modest, particularly if HoTARAC's suggestion about not requiring changes to comparatives is agreed by the AASB.

HoTARAC's other comments are as follows:

- HoTARAC's view is that the illustrative examples are of limited usefulness. While they adequately identify the factors that might lead to a for profit/not-for-profit classification in each case, our view is that the same outcome would be obtained without the examples by carefully analysing the requirements of the proposed change in standards.
- There will be some accounting policy changes required of entities that transition from not-for-profit to for-profit, even where those entities form a wholly-owned and integral part of a not-for-profit group. The AASB should consider whether any of these accounting policy changes are inappropriate for such for-profit entities. In particular, HoTARAC's view is that the capital management provisions of AASB 101 (paragraphs 134 – Aus 136.2) should be reviewed, so that reporting is not required for such entities.

12. HoTARAC's Other Comments - Continued

- Whilst referencing over-arching legislation for charities is useful, HoTARAC is of the view that state based legislation should be incorporated with extreme caution into implementation guidance (e.g. State-Owned Corporations Act 1989 (NSW), Protection of Environment Administration Act 1991). Rather than refer to statutes that could be amended, a hypothetical example appears preferable.

A minority of HoTARAC members have the following views:

- On the AASB's *Not-for-Profit Entity Standard Setting Framework*, consideration should be given to the Competitive Neutrality Reforms introduced by COAG in 1995 in allowing the AASB to better address framework paragraph 23(a) for the public not for profit sector. It is suggested that the cost and effort of preparing and auditing AASB 1049 consolidations for additional for-profit-entities within a not for profit environment also be addressed.
- Whilst the altered definition of a not-for-profit entity appears to align to circumstances in the private not for profit space, it appears to confuse established practice in the public not for profit space and will add considerable preparation and audit effort to specific agencies and AASB 1049 reporting. The benefit of this change does not appear to justify the effort.
- The move from 'not for profit' to 'for profit' will require agencies with limited resources to build impairment models and estimates, determine if the model applies to an asset or cash generating unit, and, have those models tested by audit. When the assets are held for their service potential, and some economic benefit to the jurisdiction's taxpayers, it is difficult to see the benefit derived from the costs imposed through redesignation to 'for profit' status.