



2 April 2008

The Chairman
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Dear David

Invitation to Comment ITC 14 Proposed Definition and Guidance for Not-for-Profit Entities

Thank you for the opportunity to comment on the Invitation to Comment ITC 14 Proposed Definition and Guidance for Not-for-Profit Entities. CPA Australia's comments have been prepared in consultation with members through its Financial Reporting and Governance Centre of Excellence.

CPA Australia welcomes the Australian Accounting Standards Board's (AASB) initiative to address the deficiencies in the current definition of a not-for-profit entity. However, CPA Australia does not support the proposed approach being to utilise the New Zealand Financial Reporting Standards Board (FRSB) definition of public benefit entities. CPA Australia understands that one deficiency in the current definition of a not-for-profit entity used in the Australian Accounting Standards is caused by different emphases being given to the word "principal". CPA Australia notes that the FRSB definition of a public benefit entity makes use of the word "primary". CPA Australia understands "principal" and "primary" as synonyms. Accordingly, we do not believe the use of the FRSB definition will necessarily result in an improved outcome.

CPA Australia's response to the questions posed follow (see attachment). In May 2007, CPA Australia proposed to the AASB for its consideration a sector-neutral definition of a not-for-profit entity and application guidance. The definition proposed was:

An entity shall be classified as not for profit when:

- (a) the entity has operating purposes other than to provide goods and services at a profit;
- (b) no member/owner has the right to surpluses of the entity;
- (c) that entity does not have the right to transfer ownership to members/owners; and
- (d) that entity does not have:
 - (e)
 - i. the objective of generating profit outlined in the entity's legislation, associated regulation, or other founding document; or
 - ii. as its practical objective the generation of profit.

We attach that proposal.

In late 2007 the AASB discussed the definition proposed by CPA Australia. At the recent AASB not-for-profit roundtables we reiterated the main features of that work. Some commentators have perceived problems with parts (a), (b) and (c) of the definition. We take this opportunity to respond.

- *The entity has operating purposes other than to provide goods and services at a profit*

CPA Australia understands that unlike a for-profit entity, a not-for-profit entity's goals do not primarily focus on maximising revenue or minimising expenses. For example, we understand not-for-profit entities will continue to deliver some core services at less than the market rate.¹ CPA Australia acknowledges that not-for-profit entities strive to constrain administrative and operational costs. However, unlike a for-profit entity, we understand a not-for-profit entity will continue to deliver some services to some sections of the community in spite of outflows exceeding inflows. Again we think this approach is distinguishable from the marketing strategies employed by for-profit entities.

- *No member/owner has the right to surpluses of the entity*

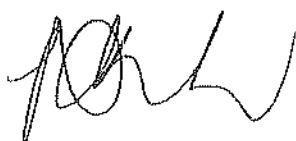
Some commentators have noted that a member not-for-profit entity with accumulated surpluses has the capacity to reduce its annual membership fees (without the need for a matching reduction in the level of service). Those commentators have said that in effect the entity is enabling its members to access the surpluses of the entity. Accordingly, they consider the application of the CPA Australia proposed definition will result in all member entities being excluded from classification as not for profit. CPA Australia disagrees. We consider that the annual membership fee does not have the attributes of equity. Accordingly, neither an increase nor decrease in the fee should be characterised as an equity transaction. We note that participants at the Melbourne not-for-profit roundtable were strongly supportive of the CPA Australia position.

- *Entity does not have the right to transfer ownership to members/owners*

Some commentators have noted that government departments are often merged, reorganised, re-badged and/or re-birthed to give rise to a new entity. The same is true of local governments. They have suggested that at some time in this process, ownership is transferred to government. Accordingly, they consider the application of the CPA Australia proposed definition will result in all government departments and local governments being excluded from classification as not for profit. CPA Australia disagrees. We note the common ownership of the new entity and its antecedent. We believe that in substance there has been no transfer of ownership.

If you have any queries on our comments, please contact John Ngiam, CPA Australia's Financial Reporting and Governance Policy Adviser via email at john.ngiam@cpaaustralia.com.au.

Yours sincerely



Geoff Rankin FCPA
Chief Executive Officer

cc M Shying
D Pratt
J Ngiam

¹ Some commentators have suggested that a not-for-profit entity's delivery of services at less than market value is analogous to a for-profit entity's loss leader approach of selling certain products at cost or below cost to stimulate other, profitable sales. CPA Australia disagrees, as the latter is an approach to building market share using a pricing strategy.



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1 May 2007

Professor David Boymai
Chairman
Australian Accounting Standards Board
PO Box 204
COLLINS STREET WEST VIC 8007

Via email: standard@aasb.com.au

Dear David

Definition of a not-for-profit entity

CPA Australia submits the following proposed sector-neutral definition of a not-for-profit entity and application guidance for consideration by the Australian Accounting Standards Board (AASB) (see also Appendix 1 for Application Guidance). We do so following your encouragement to further develop our thinking on the definition as was articulated in the Report of the CPA Australia commissioned survey of CPA Australia members (see Appendix 2).¹

An entity shall be classified as not for profit when:

- a. that entity has operating purposes other than to provide goods and services at a profit;
- b. no member/owner has the right to surpluses of the entity;
- c. that entity does not have the right to transfer ownership to members/owners; and
- d. that entity does not have:
 - i. the objective of generating profit outlined in the entity's legislation, associated regulation or constitution, or other founding document; or
 - ii. as its principal objective 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.

CPA Australia considers there is a significant need for further work on the AASB's current definition to better differentiate entities that are not for profit from those that are for profit. We consider our proposed definition is significantly more robust than the current definition and is therefore better able to achieve that objective.

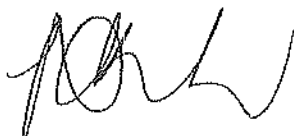
¹ We make this submission notwithstanding the AASB's decision (as reported in the Minutes of the seventy-fourth meeting of the AASB) that whilst further work on the definition of a not-for-profit entity is an important project area, it should not be among those projects that are a key focus for 2007. Further, the Minutes report the AASB noted that most of the significant decision making about distinguishing between for-profit and not-for-profit entities has already taken place.

As noted above, our submission is the result of CPA Australia's consideration of the findings of the CPA Australia commissioned survey of CPA Australia members to determine a definition of a not-for-profit entity from an accounting perspective. The Graduate School of Management at the University of Western Australia survey of a sample of public sector, academic, and not-for-profit entity members in August and September 2006 generated nearly 800 responses.

CPA Australia's Financial Reporting and Governance Centre of Excellence has considered those findings and commented on the contents of Appendix 1. One comment raised was the possibility of including an additional criteria being, "the entity is not a subsidiary of a for-profit entity". We see merit in this addition, but have not included it in our proposal for the reason that the survey respondents were not asked to consider its importance to any definition of not for profit.²

If you have any queries on our comments, please contact Dr Mark Shying, CPA Australia's Financial Reporting and Governance Senior Policy Adviser at mark.shying@cpaaustralia.com.au.

Yours sincerely



Geoff Rankin FCPA
Chief Executive Officer

cc: M Shying

² Newspaper reports have questioned whether a not-for-profit school "linked" with a listed company should be eligible for funding from state governments following recent changes to state education legislation (see "Banned school steps up NSW push", The Sydney Morning Herald, 24 June 2006). Some members have suggested that the not-for-profit school may be a special purpose entity for the purpose of Interpretation 112 *Consolidation – Special Purpose Entities*. Those members consider that an entity that is controlled by a for-profit entity should by definition not be capable of being classified as not for profit for the purpose of financial reporting.

Appendix 1

In 2006 CPA Australia commissioned the Graduate School of Management at the University of Western Australia to undertake a survey of CPA Australia members to determine a definition of a not-for-profit entity from an accounting perspective. CPA Australia members were regarded as ideal respondents as they are experienced users of accounting standards.

The survey was conducted in August and September using a sample of its public sector, academic, and not-for-profit entity members. Nearly 800 CPA Australia members responded, with the bulk (66%) having had more than 15 years' industry experience. Respondents self-selected from two versions of the survey: non-government (private) sector not-for-profit entities, and government (public) not-for-profit entities. More than half (57.8%) chose to answer from the private sector perspective, yet just over half (52.4%) were public sector members.

The survey findings are summarised in Table 1. The first six criteria are those that respondents consider to be both useful and essential for the definition of not for profit as it applies to both private and public sector entities. Of those six:

- Three clearly relate to the objectives of the organisation (items 1, 3 and 6);
- Item 4 can be treated in two ways – It can be seen as a proxy for item 2 (may not distribute surpluses) this is because the criteria for not paying income tax is that the entity is not operating for the profit or gain of its individual members. Alternatively it could be a criteria in its own right – CPA Australia's concern here would be that if the Australian Taxation Office changed its criteria for recognition as a not for profit it would have an impact on accounting regulations – and we have always understood that this type of situation was avoided by standard setters. CPA Australia prefers the first interpretation of this criterion; and
- Items 5 and 6 are separate issues to the profit objective and CPA Australia would expect these to be identified separately in any definition.

CPA Australia expects it will be necessary to supplement any definition with application guidance specifically relevant to the definition. In addition items 7 – 15 could be dealt with in the application guidance as examples of supporting criteria and (for the last three) examples of non supporting criteria.

**Table 1
Findings**

Item		Public Sector Useful	Private Sector Useful	Public Sector Essential	Private Sector Essential
1	Principal Objective	Yes	Yes	Yes	Yes
2	May Not Distribute Surpluses	Yes	Yes	Yes	Yes
3	Profit Objective Not In Legislation	Yes	Yes	Yes	Yes
4	Does Not Pay Income Tax	Yes	Yes	Yes	Yes
5	Not Able To Transfer Ownership	Yes	Yes	Yes	Yes
6	Operating Purposes Other Than Profit	Yes	Yes	Yes	Yes
7	Control Own Activities	Yes	Yes	No	Yes
8	Receives Significant NRT	Yes	Yes	No	Yes
9	Govt. Funded To Deliver At No Cost	Yes	No	Yes	n/a
10	Regular Meetings	Yes	Yes	No	No
11	Not Self-funding In Longer Term	Yes	No	No	n/a
12	Voluntary Input	No	Yes	n/a	No
13	Regulator Sets Prices	No	No	n/a	n/a
14	Monopoly Provider	No	No	n/a	n/a
15	Trades In Fully Contestable Market	No	No	n/a	n/a

CPA Australia considers that on the basis of this research, the Australian accounting standards current definition of a not-for-profit entity – “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” – does not go far enough. It does not capture five of the six criteria that CPA Australia members consider essential to defining an entity as not for profit.

CPA Australia considers it timely that the Australian Accounting Standards Board reviews its current definition of a not-for-profit entity. CPA Australia’s proposed definition and application guidance follow.

Proposed Definition

An entity shall be classified as not for profit when:

- a. that entity has operating purposes other than to provide goods and services at a profit;
- b. no member/owner has the right to surpluses of the entity
- c. that entity does not have the right to transfer ownership to members/owners; and
- d. that entity does not have:
 - i. the objective of generating profit outlined in the entity’s legislation, associated regulation or constitution, or other founding document; or
 - ii. as its principal objective 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.

Application Guidance

Introduction

1. The form of an entity is unlikely to be a conclusive factor in determining whether or not an entity is not for profit as not-for-profit entities have a wide variety of forms and purposes. (Based on NZ IAS 1.NZAG3 and Not-for-profit financial reporting guide (NZ September 2006) paragraph 1.9)
2. The forms of not-for-profit entities include public sector entities such as departments or local government, incorporated clubs and associations, unincorporated clubs and associations, trusts and companies limited by guarantee or shares. They may be established under their own legislation, be subject to general legislation such as the Corporations Law or similar state or territory legislation, or be subject to no laws at all. Some operate as a single entity while others operate in combination with other entities. Some are financed from government budget allocations, others are financed from permanent endowments or public appeals, others from regular subscriptions, and others from the proceeds of trading profits. (Based on Not-for-profit financial reporting guide (NZ September 2006) paragraph 1.9)

Operating purposes other than to provide goods and services at a profit

3. An entity must assess whether it is not for profit, by considering whether or not it meets the definition of not for profit. Assessing whether an entity meets that definition requires an entity to first determine whether it has operating purposes other than to provide goods and services at a profit. (First sentence from NZIAS1.NZAG3)
4. An entity with operating purposes other than to provide goods and services at a profit is likely to be not for profit.
5. Although in general terms not-for-profit entities exist to provide goods and services for community or social benefit, this does not necessarily imply that such entities exist for the benefit of the public as a whole. Many not-for-profit entities exist for the direct benefit of a particular group, although it is possible that society as a whole benefits indirectly. For example, a football club exists to promote and encourage football for the direct benefit of its members. However, society as a whole may benefit through a healthier population and through the provision of organised activities for its youth. (Based on NZIAS1.NZAG14)

Rights of members/owners

6. Having first determined that the entity has operating purposes other than to provide goods and services at a profit, the entity must then determine the rights of members/owners.
7. The rights of members/owners and the obligation of the entity is often established by the membership/ownership instrument. These rights can also be established by statute or common law.
8. The rights of members/owners that are to be considered in determining whether an entity is not for profit are restricted to consideration of the right of the member/owner to surpluses of the entity and the right of the entity to transfer ownership to members/owners.
9. Where an entity is established to generate a return for the benefit of the members/owners, it is usual that the membership/ownership instrument determines the rights and obligations of the parties. This is important for profit-oriented entities because it determines the level of benefits such as dividends and the rights to residual net assets. (Based on NZIAS1.NZAG29)

10. An entity is likely to be not for profit in the absence of any members/owners with the right to participate in any financial return or in the net assets of the entity were it to be wound up or to otherwise cease to operate. (Based on NZIAS1.NZAG30)

Objective

11. Having determined that the entity has operating purposes other than to provide goods and services at a profit and that the rights of members/owners are consistent with the entity being not for profit, the entity must then determine the objectives of entity.
12. For many entities the entity's legislation, associated regulation or constitution, or other founding document will specify the objectives of an entity, including for whom the benefits generated by the entity are intended. (Based on NZIAS1.NZAG17)
13. The founding documents of an entity may specify the objective of an entity in terms of the nature of the benefits the entity provides. (Based on NZIAS1.NZAG18)
14. Many entities are established with multiple objectives. (Based on NZIAS1.NZAG19)
15. Where an entity's founding document indicates that an entity has multiple objectives, none of which are the generation of profit it is a not-for-profit entity.
16. An entity with multiple objectives, and one of those objectives is the generation of profit, prima facie does not meet the requirements to be not for profit.
17. Nonetheless, an entity which does not have as its principal objective the generation of profit, is a not-for-profit entity.
18. Determining whether the principal objective of the entity is the generation of profit will depend on an assessment of the substance of the purpose of the entity. (Based on NZIAS1.NZAG20)
19. The founding document 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 profit-orientated entity from a not for profit. (Based on NZIAS1.NZAG21)

Supporting criteria

20. Paragraphs AG21 identifies criteria which, although its presence is not essential to the definition of a not-for-profit entity, may be useful in the assessment of whether an entity meets the definition of not for profit.
21. The supporting criteria which may be useful are, the entity:
- (a) is able to control its own activities
 - (b) receives contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return;
 - (c) is funded from the government budget to deliver, as its principal activity, goods and/or services for no or nominal cost to the beneficiary;
 - (d) has regular organised meetings, procedural rules and some form of organisational permanence;
 - (e) is not self-funding in the longer-term; or
 - (f) has some level of voluntary input into its operations.
22. Paragraph AG23 identifies criteria which should not be considered in the assessment of whether an entity meets the definition of not for profit.

23. The criteria which should not be considered are, the entity:
- (a) provides goods or services in a market where a regulator sets prices;
 - (b) is a monopoly player; or
 - (c) gains the majority of revenue from its trading or provision of services in a fully contestable market.

Changing classification

24. In certain situations, changing circumstances may lead to a change in an entity's classification. For example, a change in government policy may require that entities previously classified as not-for-profit entities are now to operate on a commercial basis, or vice versa. (Based on NZIAS1.NZAG33)
25. Where an entity's classification changes so that it is no longer not for profit, the entity may need to apply AASB 1 First-time Adoption of International Financial Reporting Standards, in order to assert compliance with IFRSs. Where an entity's classification changes and, as a result the entity's accounting policies change, the entity will need to ensure it complies with the requirements of AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors. (Based on NZIAS1.NZAG34)

Appendix 2

Defining a not for profit entity in Australia – The accounting perspective (report dated 28 November 2006) to be attached.



THE UNIVERSITY OF
WESTERN AUSTRALIA

Business School

GSIM

DEFINING A NOT-FOR-PROFIT ENTITY IN AUSTRALIA – THE ACCOUNTING PERSPECTIVE

Report for CPA Australia Centre of Excellence for Financial Reporting and Governance

Dated: 28 November 2006

Prepared by Researchers at the University of Western Australia:

Lydia Kilcullen, Phil Hancock and H. Izan



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1 INTRODUCTION

Australian equivalents of the International Financial Reporting Standards (AIFRS) have been developed by the Australian Accounting Standards Board (AASB) on a sector neutral basis, namely, one set of standards for all types of entities and all types of transactions.

The AIFRS do, however, include some provisions specific to Not-for-profit (NFP) entities. There has also been some discussion over the need for additional guidance for this type of entity, an important part of which is a clear ability to separately identify For Profit and NFP entities. The AIFRS contain a definition of a NFP entity, however there has been some debate over whether this definition captures all the entities it is intended to capture.

In August and September 2006 a survey of a sample of CPA members was conducted to seek their views on the definition of a NFP entity, and what they consider to be the essential characteristics of such an entity. Members of CPA Australia were invited to participate in this research because they are considered to be experienced users of accounting standards. This survey is part of ongoing research at the University of Western Australia supported by the CPA Australia Centre of Excellence For Financial Reporting And Governance and the Accounting and Finance Association of Australia and New Zealand. This paper presents the findings from the survey.

2 BACKGROUND TO RESEARCH PROJECT

In late 2003 a research project to examine financial reporting for NFP entities in Australia was initiated at the Graduate School of Management at the University of Western Australia (UWA). The early aim of the project was to firstly identify the needs of users of NFP financial reports and secondly identify the extent to which those needs were being met.

The first stage of that project was a comparative analysis of the regulatory environments of Australia, New Zealand, Canada, the United States of America and the United Kingdom. This analysis identified a number of types of information that other regulatory environments consider useful to users of NFP financial reports that are not currently included in the guidance provided by the AIFRS.

An additional and significant finding of this analysis was that there are differences between the definition of a NFP entity included in the AIFRS and the guidance from other regulatory environments. Support was found for the notion that the definition in the AIFRS is difficult to operationalise and could potentially result in similar entities being defined as NFP in some circumstances while being defined as For Profit in others.

The survey of CPA members constitutes Stage Two of the UWA research project.

3 VIEWS ON THE CRITERIA THAT DEFINE A NFP ENTITY

In order to develop a set of criteria that had the potential to be useful in defining an entity as NFP, research was undertaken to identify definitions used in Australian and other accounting regulatory environments as well as definitions from non accounting contexts. A summary of these is provided in the following subsections.

3.1 THE AUSTRALIAN STANDARD SETTERS VIEW

In Australia, the AIFRS contain the following definition of a NFP entity:

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 (AASB 114 para AUS8.1).

3.2 OTHER AUSTRALIAN VIEWS

In response to the introduction of the AIFRS definition of a NFP entity, the Heads of Treasuries Accounting and Reporting Advisory Committee (HOTARAC) developed nine criteria to assist users of the standards in assessing whether entities are For Profit or NFP. The criteria are classified into three groups:

- Primary Criteria that provide conclusive support either from a legal interpretation of the definition or substantive support from the application of the criteria
- Secondary Criteria that provide varying degrees of support for an entity's in-substance classification as being either For Profit or NFP, but which is not conclusive in isolation
- Rejected Criteria that do not provide a basis for discriminating between a For Profit and a NFP entity (HOTARAC 2005)

The Australasian Council of Auditors General Advisory Committee (AAC) prepared a similar guidance paper based on the HOTARAC report. This guidance is intended to assist Auditors General and their staff when assessing whether public sector entities are For Profit or NFP. In this guidance, the criteria were classified into two groups:

- Effective criteria for identification as a NFP entity. These criteria could be either conclusive in isolation, provide a strong but rebuttable presumption, or provide support but not be conclusive in isolation
- Rejected criteria that did not provide a basis for identification as a NFP entity (AAC 2005)

Two other definitions are included in this analysis due to their significance to Australian entities. The Australian Taxation Office (ATO) provides a definition of a Non-profit organisation. Under this definition, an entity is NFP when it is not operating for the profit or gain of its individual members. (ATO 2005)

Mark Lyons, a significant contributor to the research into defining Australian non- government NFP entities, uses a set of five criteria developed by the John Hopkins Comparative Nonprofit Sector Project. (Lyons 1998). Under this definition, non-government NFP entities must have a formal structure; be self-governing; be private; be non-profit-distributing; and have some meaningful degree of voluntary involvement.

3.3 OTHER VIEWS FROM AROUND THE WORLD

A number of regulators in other countries provide guidance to preparers of financial reports as to the criteria that define a NFP entity.

In Canada guidance is provided by the Canadian Institute of Chartered Accountants (CICA) through Section 4400 of their Handbook (CICA 1997) in which a "Not-for-Profit Organization" is defined.

In the United States of America, the Financial Accounting Standards Board (FASB) provide guidance on the distinguishing characteristics of "Nonbusiness Organizations" through Statement of Financial Accounting Concepts No. 4 "Objectives of Financial Reporting by Nonbusiness Organizations" (FASB 1980)

In New Zealand the Institute of Chartered Accountants of New Zealand (ICANZ) provide guidance in the form of Exposure Draft No. 101 "When is an Entity a Public Benefit Entity?" (ICANZ 2005). In this guidance a "Public Benefit Entity" is determined by its primary objective, with key and supporting indicators provided to assist in the determination where the objectives of the entity are not clearly stated.

In addition to the views developed by regulators, a number of commentators have presented their views on the issues of defining the sector. For example Anthony (1978) identifies several criteria for deciding how to distinguish between business and non business organisations. The first criterion is that the characteristics separating the two types of organisations should be related to accounting concepts. The second criterion is that the distinction should be operational.

Anthony also discusses the need for the ability to separately identify For Profit and NFP entities if sector specific standards are to exist:

"Although to some people the problem of drawing a line between business organizations and other organizations appears to be of only academic interest, such a line has a fundamental practical purpose. If two sets of concepts exist, a given organization must have some way of knowing which set governs its accounting."
(Anthony 1978, pp 159)

3.4 SUMMARY

From the review of the literature a large set of criteria were identified as possibilities when defining a NFP entity. This larger set was distilled down to the 15 criteria that were included in the survey. These criteria are shown in Table 1.

Some criteria were excluded as it was felt that they were similar to others. For example the following AAC and HOTARAC criterion was excluded as it was felt to be similar to other profit related criteria:

- Do the financial targets of the entity reflect profit concepts or an objective to be commercially successful

The Lyons (1998) definition - which is defining non government NFP entities - contains the criterion that the entity is private. This was excluded from the final set of criteria.

Table 1 – Criteria included in the survey

Source(s)	Criteria
AIFRS, ICANZ, Anthony	It does not have as its principal objective the generation of profit
Lyons	It is organised e.g. it has regular meetings, procedural rules, some form of organisational permanence

Source(s)	Criteria
Lyons, CICA, FASB, AAC, HOTARAC, ATO, ICANZ, Anthony	It may not distribute surpluses
Lyons	It is able to control its own activities
Lyons	It has some level of voluntary input into its operations e.g. volunteers
AAC, HOTARAC, ICANZ	It does not have in its legislation, associated regulations or constitution, the objective of the generation of profit
AAC, HOTARAC	It is funded from the government budget to deliver, as its principal activity, goods and/or services for no or nominal cost to the beneficiary
AAC, HOTARAC	It is not self-funding in the longer-term
AAC, HOTARAC	It does not pay income tax or income tax equivalents
AAC, HOTARAC	It provides goods or services in a market where a regulator sets prices (Note that this criteria was considered but rejected by the AAC)
AAC, HOTARAC	It is a monopoly provider (Note that this criteria was considered but rejected by the AAC)
AAC, HOTARAC	It gains the majority of revenue from its trading or provision of services in a fully contestable market (Note that this criteria was considered but rejected by the AAC)
CICA, FASB, Anthony	It is not able to transfer ownership
FASB, Anthony	It receives contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return
FASB, CICA	It has operating purposes other than to provide goods or services at a profit

4 METHODOLOGY

This survey was distributed through an email to the sample group inviting them to participate and providing a link to the web site hosting the survey. The sample was selected from the approximately 108,000 members of CPA Australia as at August 2006 was selected. An initial sample of 15,702 included all members with an email contact who indicated that they were employed in the following groups:

- Public Sector (including government business entities) 65.6% of the sample
- Academia 16.9% of the sample

- Not-for-profit Private Sector 17.5% of the sample

Of the emails sent, 251 bounced back making a total of 15,451 in the final sample. The survey was opened on 23rd August 2006 and closed on 14th September 2006 leaving it open for a total of 23 days.

A total of 860 responses were received, resulting in a response rate of 5.6%. While this rate is low, it is not inconsistent with surveys of this nature. Also, the actual number of respondents is sufficiently large, thus providing very useful insights into this important issue.

5 FINDINGS

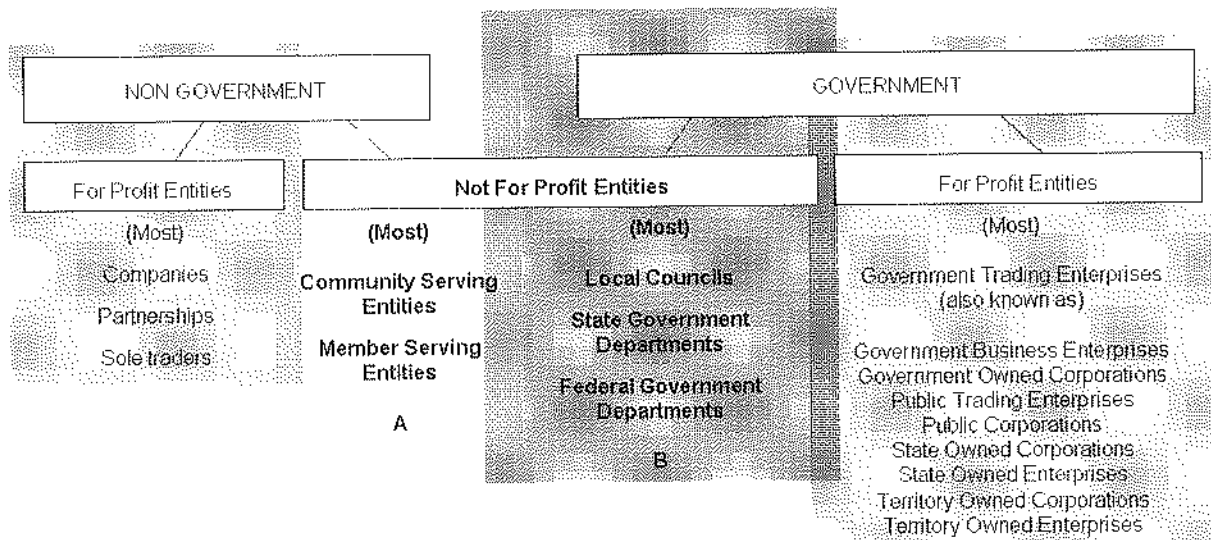
5.1 ABOUT THE RESPONDENTS

Data was collected about the respondents than can be used to evaluate the findings. Respondents were asked to:

- respond with respect to a particular type of NFP entity
- identify their area of employment
- identify their years of work experience
- identify their highest level of university qualification

In the introduction to the survey, a diagram was presented to the respondents with a view of where NFP entities are placed within the spectrum of Australian entities:

Figure 1 – Types of Australian Entities



The first (compulsory) question answered by respondents was to choose to respond to the survey with respect to one of two groups of NFP entities. Table 2 depicts the number of respondents choosing each category of NFP entity and in total.

Table 2 - Breakdown of type of entity chosen by respondents

	Total	Percent (%)
Non Government (Private) Sector Not-For-Profit Entities	497	57.8
Government (Public) Sector Not-For-Profit Entities	363	42.2
Total	860	100.0

Of the 860 respondents, 57.8% chose to respond with respect to Private Sector NFP entities which include most community serving and member serving entities. 42.2% of respondents chose to respond with respect to Public Sector NFP entities which include most local councils and most state and federal government departments.

Tables 2, 3 and 4 present the data collected on other characteristics of the respondents. Total of less than 860 reflect instances of where no response was provided.

Table 3 – Breakdown by area of employment of respondents

	Total	Percent (%)
Non Government (Private) Sector	324	37.7
Government (Public) Sector	450	52.4
Retired	6	0.7
Other	79	9.2
Total	859	100.0

Table 4 – Breakdown by years of work experience of respondents

	Total	Percent (%)
Less than 2 years	15	1.7
Between 2 and 5 years	59	6.9
Between 6 and 10 years	108	12.6
Between 11 and 15 years	109	12.7
More than 15 years	569	66.1
Total	860	100.0

Table 5 – Breakdown of highest level of university qualification of respondents

	Total	Percent %
Undergraduate Degree	538	62.6
Non MBA Masters	79	9.2
MBA	71	8.3
Post Masters Qualification	46	5.4
Other	124	14.5
Total	858	100.0

5.2 QUESTIONS ASKED OF RESPONDENTS

Respondents were asked to indicate the extent to which they agreed or disagreed that each of the 15 criteria listed was useful when determining whether an entity should be defined as NFP.

Where a response of Agree or Strongly Agree was given a further question was posed with respondents asked to indicate whether they considered the criteria to be:

- **PRIMARY** criteria are those which respondents consider are essential components of a definition of a NFP entity. Failing to meet one of these criteria would result in an entity being classified as For Profit.
- **SECONDARY** criteria are those which respondents consider provide support when classifying an entity as NFP but are not conclusive in isolation. Failing to meet one of these criteria would not result in an entity being classified as For Profit

The following two sections present the findings of all responses as well as responses split between the two groups based on the type of entity chosen by the respondents at the start of the survey (Private sector NFP or Public Sector NFP).

5.3 ALL RESPONSES

Tables 6 and 7 present all 860 responses to the survey. The numbers in the columns represent the percentage of respondents choosing that response. Shaded numbers represent the most common response.

Table 6 – All Respondents – Which criteria are useful

Criteria (See Section 3.4 for an expanded explanation of these criteria)	Strongly Agree	Agree	Neither Agree nor Disagree	Disagree	Strongly Disagree
Principal Objective	58.0	30.5	4.1	6.2	1.2
May Not Distribute Surpluses	47.2	31.7	9.0	9.5	2.6
Operating Purposes Other Than Profit Objective Not In Legislation	46.7	42.7	4.4	4.9	1.3
Does Not Pay Income Tax	38.2	37.0	11.7	10.3	2.8
Control Own Activities	37.7	37.6	10.4	11.1	3.2
Receives Significant NRT	21.9	46.4	16.7	13.1	1.9
Regular Meetings	14.5	44.8	21.1	14.9	4.7
Not Able To Transfer Ownership	30.3	42.5	12.8	9.6	4.8
Voluntary Input	23.7	37.1	20.7	14.8	3.7
Govt. Funded To Deliver At No Cost	13.9	33.6	23.8	21.9	6.8
Trades In Fully Contestable Market	15.9	30.6	15.7	26.2	11.6
Not Self-funding In Longer Term	4.6	21.1	26.8	32.2	15.3
Regulator Sets Prices	10.4	25.2	20.0	33.3	11.1
Monopoly Provider	3.9	15.0	29.4	35.7	16.0
	3.7	9.1	21.6	38.5	27.1

Table 7 – All Respondents – Primary and secondary criteria

Criteria (See Section 3.4 for an expanded explanation of these criteria)	Number of Respondents who either Agree or Strongly Agree	Primary Criteria	Secondary Criteria
Operating Purposes Other Than Profit	766	81.3	18.7
Principal Objective	757	86.1	13.9
May Not Distribute Surpluses	673	75.2	24.8
Profit Objective Not In Legislation	640	72.5	27.5
Does Not Pay Income Tax	639	59.3	40.7
Regular Meetings	621	47.5	52.5
Control Own Activities	577	46.6	53.4
Not Able To Transfer Ownership	520	60.0	40.0
Receives Significant NRT	506	48.8	51.2
Voluntary Input	403	30.3	69.7
Govt. Funded To Deliver At No Cost	395	56.5	43.5

Table 6 indicates that for 11 of the 15 criteria, the most common response was agree or strongly agree that the particular criterion was useful when defining a NFP entity. It also shows that the three criteria rejected by the AAC and HOTARAC were also rejected by the respondents as a group with the most common response being to disagree that the criteria were useful. The one criterion that went against the trend was whether the entity was not self-funding in the longer term – the expected response was one of agreement in line with

the AAC and HOTARAC guidelines, however the survey group as a whole most commonly disagreed that this criteria was useful.

Table 7 presents the results of those respondents who either agreed or strongly agreed that the criterion was useful AND responded to the question of whether it was a Primary or Secondary Criteria.

Here we see how the survey respondents as a group ranked the 11 criteria they consider useful when defining a NFP entity. Seven of those criteria were considered essential to the definition of an entity as NFP while four were considered to be supporting and not conclusive in isolation.

Of the seven essential criteria, three relate to the purposes or objective of the entity:

- It has operating purposes other than to provide goods or services at a profit
- It does not have as its principal objective the generation of profit
- It does not have in its legislation etc, the objective of the generation of profit

Two of the criteria relate to the rights of members and/or owners:

- It may not distribute surpluses
- It is not able to transfer ownership

The criterion that the entity does not pay tax or income tax equivalents is also related to the rights of members and/or owners in that the ATO's definition of a NFP entity is that it is not carried on for the profit or gain of its individual members.

The final criterion considered by the majority of respondents as essential is that it is funded by the government budget to deliver, as its principal activity, goods and/or services for no or nominal cost to the beneficiary. This result is unexpected given that this characteristic is not present for many private sector NFP entities - for example for member serving entities such as sporting facilities and professional organisations.

A more detailed picture can be seen when the responses are split into two groups.

5.4 RESPONSES SPLIT BETWEEN PUBLIC AND PRIVATE SECTOR

Tables 8 and 9 present the responses from the 497 respondents who selected private sector NFP entities as defined in Section 5.1. Tables 10 and 11 present the responses from the 363 respondents who selected public sector NFP entities.

Table 8 – Private Sector Respondents – Which criteria are useful

Criteria (See Section 3.4 for an expanded explanation of these criteria)	Strongly Agree	Agree	Neither Agree nor	Disagree	Strongly Disagree
Principal Objective	54.8	30.6	5.2	7.8	1.6
May Not Distribute Surpluses	59.8	27.4	4.8	6.0	2.0
Operating Purposes Other Than Profit	47.5	42.3	3.8	5.0	1.4
Profit Objective Not In Legislation	39.6	33.6	14.1	10.5	2.2
Does Not Pay Income Tax	41.9	39.2	8.2	8.5	2.2
Control Own Activities	29.9	51.1	12.5	5.7	0.8
Receives Significant NRT	15.9	43.5	20.1	15.1	5.4
Regular Meetings	35.8	44.2	11.5	6.1	2.4
Not Able To Transfer Ownership	23.0	35.7	22.0	16.1	3.2
Voluntary Input	19.4	41.9	20.2	14.5	4.0
Govt. Funded To Deliver At No Cost	6.7	22.8	20.6	32.8	17.1
Trades In Fully Contestable Market	4.2	24.0	29.2	27.7	14.9
Not Self-funding In Longer Term	5.8	17.5	21.4	40.4	14.9
Regulator Sets Prices	1.8	10.3	27.3	40.2	20.4
Monopoly Provider	1.2	3.4	17.2	40.7	37.5

Table 9 - Private Sector Respondents – Primary and secondary criteria

Criteria (See Section 3.4 for an expanded explanation of these criteria)	Number of Respondents who either Agree or Strongly Agree	Primary Criteria	Secondary Criteria
Operating Purposes Other Than Profit	445	80.7	19.3
Principal Objective	423	82.5	17.5
May Not Distribute Surpluses	431	82.6	17.4
Profit Objective Not In Legislation	361	71.5	28.5
Does Not Pay Income Tax	400	61.8	38.2
Regular Meetings	394	49.5	50.5
Control Own Activities	392	51.5	48.5
Not Able To Transfer Ownership	291	60.1	39.9
Receives Significant NRT	295	50.5	49.5
Voluntary Input	302	31.8	68.2

Table 10 – Public Sector Respondents – Which criteria are useful

Criteria (See Section 3.4 for an expanded explanation of these criteria)	Strongly Agree	Agree	Neither Agree nor Disagree	Disagree	Strongly Disagree
Principal Objective	62.7	30.3	2.5	3.9	0.6
May Not Distribute Surpluses	30.3	37.5	14.6	14.3	3.3
Operating Purposes Other Than Profit Objective Not In Legislation	45.7	43.3	5.2	4.7	1.1
Does Not Pay Income Tax	36.1	41.6	8.5	10.2	3.6
Control Own Activities	31.9	35.7	13.3	14.7	4.4
Receives Significant NRT	11.0	40.4	22.4	22.9	3.3
Regular Meetings	12.5	46.8	22.4	14.7	3.6
Not Able To Transfer Ownership	22.9	40.2	14.6	14.3	8.0
Voluntary Input	24.8	38.9	19.0	12.9	4.4
Govt. Funded To Deliver At No Cost	6.4	22.4	28.7	32.0	10.5
Trades In Fully Contestable Market	28.7	41.0	9.1	17.1	4.1
Not Self-funding In Longer Term	5.0	17.1	23.8	38.4	15.7
Regulator Sets Prices	16.6	35.6	18.2	23.8	5.8
Monopoly Provider	6.6	21.3	32.5	29.6	10.0
	7.2	16.8	27.5	35.6	12.9

Table 11 – Public Sector Respondents – Primary and secondary criteria

Criteria (See Section 3.4 for an expanded explanation of these criteria)	Number of Respondents who either Agree or Strongly Agree	Primary Criteria	Secondary Criteria
Operating Purposes Other Than Profit	321	82.2	17.8
Principal Objective	334	90.7	9.3
May Not Distribute Surpluses	242	62.0	38
Profit Objective Not In Legislation	279	73.8	26.2
Does Not Pay Income Tax	239	55.2	44.8
Regular Meetings	227	44.1	55.9
Control Own Activities	185	36.2	63.8
Not Able To Transfer Ownership	229	59.8	40.2
Receives Significant NRT	211	46.4	53.6
Govt. Funded To Deliver At No Cost	250	65.2	34.8
Not Self-funding In Longer Term	186	39.2	60.8

5.4.1 Where there is consensus

When the private and public sector responses are analysed separately, results indicate that both groups agree or strongly agree that nine of the 15 criteria are useful. Of those nine, both groups agree that the following six criteria are both useful and essential when defining an entity as NFP:

- It has operating purposes other than to provide goods or services at a profit
- It does not have as its principal objective the generation of profit
- It may not distribute surpluses
- It does not have in its legislation, associated regulations or constitution, the objective of the generation of profit
- It does not pay income tax or income tax equivalents
- It is not able to transfer ownership

These results indicate that preparers find a range of criteria essential components of a definition of a NFP entity in both the public and private sectors. This is in contrast to the current AIFRS definition that includes only the second of the above criteria.

Of the other three criteria that both groups agree are useful, there is consensus that the following criterion while being useful is not essential. Both groups agree that this criterion provides support when classifying an entity as NFP but is not conclusive in isolation:

- That the entity is organised

The private and public sector groups agree that the following two criteria are useful however, they differ on whether they are essential or supportive:

- It is able to control its own activities
- It receives contributions of significant amounts of resources from resources providers who do not expect commensurate or proportionate pecuniary return

Neither private nor public sector respondents considered the following three criteria were useful, however each group varied in the strength of their response:

- It provides goods or services in a market where a regulator sets prices
- It gains the majority of revenue from its trading or provision of services in a fully contestable market
- It is a monopoly provider

This result is not unexpected given the rejection of these criteria by AAC and the HOTARAC.

These results indicate that while there is significant consensus on the 'big picture' for 80% of the criteria, there are differences relating to the strength of opinions and the weighting given to a number of criteria.

5.4.2 Where there is a lack of consensus

The majority of public sector respondents disagreed with their private sector counterparts that some level of voluntary input into its operations was a useful criterion which is not surprising given that public sector entities are much less likely to include volunteers than private sector NFP entities. This criterion comes from the Lyons (1998) definition of non-government NFP entities.

The majority of public sector respondents also differed from the private sector by agreeing that not being self-funding in the longer-term was a useful criterion. This result is again not surprising given the inclusion of this criterion by the HOTARAC who consider it to be useful when defining public sector NFP entities. One reason for private sector respondents disagreeing with the usefulness of this criterion may be an understanding that private sector viability is dependent on an ability to be self-funding whether the entity is For Profit or NFP, whereas in the public sector this is not necessarily the case. It may be that this characteristic separates Public and Private sector entities rather than For Profit and NFP entities.

In contrast with public sector respondents, the majority of private sector respondents disagreed that funding from the government budget to deliver, as its principal activity, goods and/or services for no or nominal cost to the beneficiary was a useful criterion for defining and entity as NFP. It may be that this criterion – identified by the AAC and the HOTARAC – does not apply to many private sector entities who may not receive government funding or do not receive it for provision of their principal activity, or do not provide goods and/or services for no or nominal cost to the beneficiary. Member serving NFP entities such as sporting clubs are one group of NFP entities that would not find these criteria relevant to their organisations.

These findings indicate that preparers from each sector differ in their opinion of whether or not 20% or three of the criteria included in the survey are useful when defining an entity as NFP.

6 IMPLICATIONS FOR AUSTRALIAN REGULATORS

The current definition of a NFP entity contained in the AIFRS does not capture many of the criteria that preparers consider essential to defining an entity as NFP. These preliminary results indicate that the AASB may want to consider the results of this study when reviewing the current definition of a NFP entity. Such a review will find it useful to consider both the usefulness of criteria and whether they are considered essential or supporting to the definition of a NFP entity.

While there is significant consensus, there is also disagreement between preparers considering public and private sector NFP entities over which criteria are essential to defining NFP entities in the two sectors. These preliminary results indicate that no one definition will capture both Private and Public Sector NFP entities. The AASB may want to consider developing a definition of a NFP entity that takes into account the differing needs of each sector. Other regulatory environments and accounting bodies provide guidance that will be useful in identifying differences between private and public NFP entities.

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