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The Chairman
 Australian Accounting Standards Board
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Dear Chairman

ITC 14 – Proposed Definition and Guidance for Not-for-Profit Entities

Thank you for the opportunity to comment on this topic, which is a fundamental issue for the not-for-profit (NfP) sector. Before responding to the specific matters on which comment is sought, I would like to make the following general comments.

ITC 14 is one of many recent 'reviews' which might impact on financial reporting by NfPs. These reviews include:

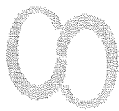
- ITC 12 issued by the AASB, which sought comment on a *Proposed Revised Differential Reporting Regime for Australia*
- the Federal Treasurer's June 2007 discussion paper, *Financial Reporting by Unlisted Public Companies*
- the Victorian Government's *Review of the Impact of Victorian Government Regulation and Other Reporting Requirements on the Not-for-Profit Sector*
- the Victorian Government's review of *Associations Incorporation Regulations 1998*

It is hoped that there is an organisation or body that is co-ordinating these reviews to ensure the NfP sector is provided with a consistent regulatory and reporting framework that is adopted across all jurisdictions.

Furthermore, it is hoped that this regulatory and reporting framework is developed for the exclusive application by non-government NfP entities. The current intermingling of government entities and non-government NfP entities when developing financial reporting approaches causes some lack of clarity and some complexity in the application of accounting standards by Australian NfPs.

This lack of clarity and complexity is exacerbated by the inclusion of NfP specific paragraphs in the sector neutral Australian Equivalents of International Financial Reporting Standards (AIFRS).

I am therefore concerned the New Zealand FRSB's Application Guidance specifies, by way of footnote, "*If a subsidiary or business unit is required to prepare general purpose financial reports its designation is determined by its own primary objective and not that of the parent of the group reporting entity.*" This reflects the current situation in Australia, and leads to unnecessary complexity in Australian NfP financial reporting.



For example, AIFRS include NfP specific paragraphs. The inclusion of these paragraphs in AIFRS has led the AASB to provide what is accepted by the NfP sector as informal guidance in the application of these Standards in a document entitled "*Not-for-profit entity requirements in Australian Accounting Standards (Updated November 2005)*"¹.

Part A of that document, which deals with "*Issues and accounting treatments when a NFP parent has a for-profit subsidiary*", is particularly complex.

The need to restate the general purpose financial report of a subsidiary or business unit, to enable consolidation with the financial report of an NfP parent entity that applies the NfP specific paragraphs in AIFRS, results in the waste of precious NfP administrative resources.

I contend that financial reports of for-profit subsidiaries or business units of NfP parent entities would not lose any relevance if they were to adopt the accounting policies adopted by the parent entity. If the AASB accept this contention, then this is yet another reason for an NfP sector specific financial reporting regime that exempts for-profit subsidiaries or business units of NfP parent entities from the need to *determine its own primary objective* when preparing its financial report. The primary objective of these for-profit subsidiaries or business units is inextricably linked with that of the parent entity and is, therefore, that of the parent entity.

1. Terminology – use of the term ‘public benefit entity’

Generally, I have no issue with the use of the term ‘public benefit entity’ (PBE), although it may take some time before it gains general acceptance and replaces ‘not-for-profit’.

The adoption of PBE may cause confusion with the term ‘public benevolent institution’ used by the Australian Taxation Office (ATO). The ATO uses this term to describe ‘a *non-profit institution organised for the direct relief of poverty, sickness, suffering, distress, misfortune, disability or helplessness.*’

2. The Status of the Guidance as an integral part of an Accounting Standard

‘The Board would envisage any guidance being located in an Appendix that is an integral part of AASB 101 Presentation of Financial Statements’

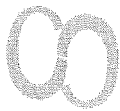
In my opinion, PBEs should have a financial reporting regime designed to meet their specific needs. PBE specific accounting standards – not just the inclusion of specific paragraphs in otherwise sector neutral standards – are essential.

I trust that the reasons I have this opinion become apparent from my responses to the issues for comment included in ITC 14.

3. Requirement to disclose that an entity is a profit-oriented entity or a public benefit entity

I have no issue with this requirement. I believe the requirement will improve transparency in reporting, by requiring those responsible for the governance of PBEs to make a conscious decision regarding the status of the entity.

¹ Available at www.aasb.com.au/whatsnew/staff_articles/NFP_requirements_Nov_2005.pdf



The need to make this decision on an annual basis would remind a PBE's governing body of the PBE's *raison d'être* – the reason for its existence.

I do, however, have issues with the practical application of the Guidance.

4. Definition of PBE

The New Zealand Application Guidance defines PBEs as:

“Reporting entities whose primary objective is to provide goods or services for community or social benefit and where equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders.”

This definition is preferred to the current definition of an NfP entity used in Australian Accounting Standards – *“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.”*

The New Zealand FRSB's definition is preferred because it provides a clear indication of 'what a PBE entity is about' – the provision of goods or services for community or social benefit without an expectation of a financial return by the equity providers or the requirement of management that they manage to generate that return.

5. Guidance for identifying a PBE

I foresee two practical difficulties in applying the Guidance.

The first is indicated by Scenario 2 included in the Guidance. In that Scenario, it is noted that, *“The directors aim to ensure that the return on the net assets invested in the shop is at least equivalent to a market return. If Company 1 does not generate adequate return the directors may recommend that the trust invest its funds in another activity. This may indicate that Company 1 is by nature an investment and therefore profit oriented.”*

I anticipate the situation where the status of an entity for financial reporting purposes might change according to the attitude of the directors to expected 'returns on investments'. Successive governing bodies of a PBE might have different attitudes, which could result in the regular restatement of financial statements in accordance with Accounting Standard AASB 108, *Accounting Policies, Changes in Accounting Estimates and Errors*.

That is, changes in attitude of a governing body to expected returns from the sale of goods and services might result in regular changes in the financial reporting status of the entity from PBE to profit-oriented entity and back again.

The other practical difficulty is the likely attitude of the ATO. Consider the situation where the governing body of an entity with tax exempt status determines it is a profit-oriented entity and issues financial reports reflecting that determination. What attitude will the ATO take? Will it levy income tax on the entity as if it were a for-profit entity, even though the entity uses the 'profit' from its activities to provide goods or services for community or social benefit? Will governing bodies be more likely to follow guidance regarding the application of accounting standards or arrive at a conclusion based on *intuition* and *professional judgement* that preserves an entity's tax free status?



And finally, consider the position of the entity's auditor in such a situation who is required to use the objective criteria specified in the Guidance. Could we see a situation where an auditor reaches a different conclusion to that of the governing body regarding the status of an entity, and must therefore qualify his or her audit opinion on the entity's financial report?

I trust you find these comments useful.

Stewart J Leslie FCA.