



31 March 2008

The Chairman
Australian Accounting Standards Board
P O Box 204
Collins Street West Victoria 8007
AUSTRALIA

Dear Sir

BDO KENDALLS COMMENTS ON ITC 14, PROPOSED DEFINITION AND GUIDANCE FOR NOT-FOR-PROFIT ENTITIES

We would like to thank the AASB for the opportunity to comment on the proposed definition and guidance for Not-For-Profit Entities.

We strongly believe that financial reporting in this sector needs to be enhanced and that the AASB should urgently address improving presentation and disclosure issues for entities in this sector. We do not believe that this paper and the proposed change in definition address the major issue facing the sector, particularly charities. Indeed the “grouping” of too many entities within the definition of not-for-profit may further delay the development of appropriate disclosure requirements for entities within this sector. We believe it should be clearly recognised that the Not-For-Profit sector covers three significant areas:

- 1) Government (and arms of government)
- 2) Charities
- 3) Member based organisations (sporting clubs, co-operatives mutual ADI’s etc)

There are fundamental differences between the aims and objectives of these organisations, together with their relative importance to Australian society and the overall Australian economy. In particular we believe an appropriate disclosure standard be developed for charities showing performance of the charity in allocating funds to specific causes/projects, cost incurred on administration etc is urgently required.

Specific Comments

Re New Zealand FRSB’s, terminology – use of the term “public benefit entity”

Whilst we understand that this description is perhaps a more appropriate in respect of the aims of entities within the sector it does appear to have two major failings:

- 1) A large number of commercial operations may be judged as operating for the public benefit and
- 2) Do small membership organisations clearly satisfy this description?

The proposed definitions fails as:

- a) There are many “for profit” entities which either provide crucial services for the public benefit, (eg communication, utilities, health care) are clearly operating for the public benefit and
- b) Small membership organisations that are only for the benefit of a very small group rather than for the public as a whole may struggle to meet the definition.

We believe that the term “Not-For-Profit” is well understated in Australia and has been used internationally and that the New Zealand paper does not justify any change in terminology.

Definition of the Public Benefit Entity

We believe that the pages of specific implementation guidance, following the definition is a significant indication that the definition is weak and struggles to define the characteristics of the entities as within their sector.

In considering the proposed definition it is perhaps appropriate to consider the two components separately.

“reporting entities whose primary objective is to provide goods or services for community or social benefit ...”

This part of the objective is far too broad and would cover a large number of entities in the “for profit” sector, including professional sporting clubs, medical research, health providers utility and communication companies, and may well confuse the application of the definition.

“,,, and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders”.

We believe that this second part of the definition is clearly more relevant in distinguishing entities in this sector from those entities in the “for profit” sector, we do however have some reservations as to the clear principle being put forward. Recognising that there are a large number of mutual type organisations such as credit unions, co-operatives, RSL’s whereby members get financial benefits by way of receiving discounted goods and services as a result of the organisation having generated a surplus. The definition as put forwards could be read literally as there having to be an equity investment and a dividend plan in order to be a for profit entity. If this is the case it would be very easy to structure commercial entities to meet this definition eg establish a commercial professional football team, only funded by debt could well meet the definition put forward.

We believe the definition should outline the principle. Potentially being that a “not-for-profit” entity has the characteristics that members/shareholders do not receive any payments of dividends and they would receive no financial benefit upon liquidation or winding up of the entity.

In conclusion we do not support the change in terminology to public benefit entities. We believe the definition is weak and does not clearly articulate the principles that distinguish a public benefit entity from entities in the commercial sector. The weak definition then consequently results in paragraphs of guidance to compensate for the lack of a clearly defined principle.

Guidance for identifying a public benefit entity

We believe that the numerous detailed guidance paragraphs demonstrates the weakness of the definition and in a number of circumstances expands on areas not immediately covered by the definition or in other circumstances refer to very specific New Zealand circumstances not relevant to Australia.

Specific queries on the guidance would include: in NZ AG17 “the quantum of expected financial surplus”. Most not for profits whilst not being driven by commercial demands of shareholders and investors, do generate large surplus so as to continue to provide benefits to the community and members, whilst a large number of commercial operations make small profits or generate significant losses (eg start up Bio tech companies).

NZ AG 18 “be a good employer”, most commercial organisations strive to be good employers.

NZ AG 18 “exhibit a sense of social responsibility” again this social responsibility is a characteristic of many commercial organisations.

NZ AG 23 discussing mixed indications. “In this situation professional judgement is required”. Again without a clearly defined principle and with indicators that in some cases are not clear to leave classification to “professional judgement”, is not the role of implementation guidance.

Requirement to disclose that an entity is profit orientated entity or public benefit entity.

We believe that it is appropriate for the classification of the entity to be disclosed and to outline in the case of a PBE the areas where the decision would have given rise to different accounting (impairment, inventory grants etc).

Status of guidance as an integral part of an Accounting Standard

In general we support the concept of inclusion into the standard, as generally it is very difficult to justify ignoring this guidance – even if labelled as not forming part of the standard. However in the case of the guidance contained in this specific standard we have serious concerns over large elements of its relevance and application.

Yours sincerely
BDO Kendalls



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Partner