



Project:	For-profit and not-for-profit Standard-setting frameworks	Meeting	AASB February 2018 (M162)
Topic:	Review of responses to ITC 37	Agenda Item:	11.1
Contact(s):	James Barden jbarden@asb.gov.au (03) 9617 7634 Clark Anstis canstis@asb.gov.au (03) 9617 7616	Project Priority:	Medium
		Decision-Making:	Medium
		Project Status:	Consider comments on ITC

Introduction and objective of this paper

- 1 The objective of this paper is to provide the Board with a summary of the feedback received on Invitation to Comment ITC 37 *The AASB's Standard-Setting Frameworks for For-Profit Entities and Not-for-Profit Entities*.
- 2 This paper is structured as follows:
 - (a) list of respondents; and
 - (b) a summary of comments received in accordance with the specific matters for comment in ITC 37 accompanied by Staff recommendations for the Board.

Attachments

- Agenda item 11.2 *ITC 37 The AASB's Standard-Setting Frameworks for For-Profit Entities and Not-for-Profit Entities* (October 2017); and
- Agenda item 11.3 Comment letters received on ITC 37 (refer to supporting folder).

Background

- 3 ITC 37 was released in October 2017 for a public comment period of approximately 90 days. As discussed at the May 2017 AASB Strategy Day, and June and August 2017 Board meetings, ITC 37 proposes two new frameworks:
 - (a) the *Not-for-Profit Entity Standard-Setting Framework*, intended to be a replacement of the current policy statement *Process for Modifying IFRSs for PBE/NFP*, which does not adequately reflect the current processes used by the AASB, nor is clear enough to assist in making decisions; and
 - (b) the *For-Profit Entity Standard-Setting Framework*, a new document intended to assist the Board in determining when or if IFRS should be modified, and when additional requirements might be appropriate for for-profit entities.

Summary of Staff recommendations

- 4 In order to develop the Standard-setting frameworks proposed in ITC 37, Staff recommend the following:
- (a) the Board retain the term ‘not-for-profit’ and consider providing further guidance on applying the term;
 - (b) the Board develop guidance to apply the definition of a ‘not-for-profit entity’, based on the NZASB’s project to improve its guidance to the term ‘public benefit entity’; and
 - (c) the Board update and clarify the standard-setting frameworks to:
 - (i) clarify how the framework addresses and sets guidelines for the AASB’s strategy to develop external reporting requirements beyond financial reporting.
 - (ii) clarify the AASB’s approach to IPSAS Standards; and
 - (iii) review the structure of the standard-setting frameworks.

Staff analysis

- 5 The Board received 11 comment letters from a range of entities and people active in both the for-profit and not-for-profit sectors (listed in the below table). The following analysis summarises the comments received in order to assist the Board in deciding how to develop the standard-setting frameworks proposed in ITC 37. Some comments to ITC 37 appear to be more appropriately addressed in other AASB projects, such as Reporting Service Performance Information or the Australian Financial Reporting Framework project. Staff have notified such comments to the relevant project teams for further consideration.

List of respondents

Submission no.	Respondent	Type of Organisation
S1	Keith Reilly	Consultant
S2	Southern Waste Solutions (SWS)	Preparer
S3	CPA Australia (CPAA)	Professional body
S4	Customer Owned Banking Association (COBA)	Preparer representative body
S5	Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC)	Public sector preparer representative body
S6	Ernst & Young (EY)	Professional services firm

Submission no.	Respondent	Type of Organisation
S7	Australasian Council of Auditors-General (ACAG)	Public sector auditors representative body
S8	Business Council of Co-operatives and Mutuals (BCCM)	Preparer representative body
S9	Chartered Accountants Australia and New Zealand (CAANZ)	Professional body
S10	Australian Institute of Company Directors (AICD)	Preparer representative body
S11	KPMG	Professional services firm

Summary of Comments Received

- 6 Respondents generally favoured the use of the term ‘not-for-profit’, however the majority requested more guidance on how it applies, in particular to entities that do not have a clear *primary* objective to not earn profit.
- 7 Staff observe that respondents generally supported the remaining content of the frameworks, but required clarification in areas to address:
- (a) how the frameworks interact with the Board’s objective to develop reporting requirements beyond financial reporting;
 - (b) the Board’s approach to IPSASB Standards; and
 - (c) the structure, purpose and force of the frameworks.

Specific Matters for Comment

SMC 1 Is the term “not-for-profit” helpful to understand the nature of the entities in that sector? If not, what other term do you consider is more appropriate?

Respondent comments

- 8 Only one respondent (S1 – Keith Reilly) fully supported that the term is in itself helpful to understand the nature of the entities.
- 9 The majority of respondents support the Board using the term “not-for-profit” to distinguish between the two types of entities, but raise concern with the current definition and available guidance in applying the term. These comments are further discussed as part of SMC 2. Respondents noted that the term is now widely used in various forms of literature (e.g. accounting Standards, laws and regulations), and that the term is widely accepted despite some concerns over its understandability.

- 10 A minority of respondents did however suggest alternate terms:
- (a) two respondents (S5 – HoTARAC, S7 – ACAG) suggested “public benefit entity”, as used in New Zealand and the UK, noting that “public benefit entity” more appropriately focuses on the non-financial objectives of not-for-profit entities; and
 - (b) one respondent (S2 – SWS) suggested “non-commercial”, noting that “not-for-profit” is unhelpful and misleading, as it might be interpreted as “non-profit”, whereas any entity that does not earn profit from their operations would be unsustainable.

Staff recommendation

- 11 Staff recommend that the Board retain the term ‘not-for-profit’ and consider providing further guidance on applying the term.

SMC 2 Irrespective of your response to question one, is there enough guidance about which entities are, for-profit entities and not-for-profit entities? The NZASB is commencing a project to improve its guidance. Should the AASB work with NZASB on this?

Respondent comments

- 12 Despite general support to retain the term “not-for-profit”, almost all respondents requested further guidance on determining whether an entity is for-profit or not-for-profit.
- 13 A minority requested the AASB to revise the current definition. AASB 102 *Inventories* (paragraph Aus6.1) currently contains the following definition of 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.*
- 14 Respondents referred to the definition and guidance of a not-for-profit as it currently exists as ‘binary’, ‘too simplistic’, ‘too narrow’, ‘problematic’ and ‘does not adequately describe the nature of NFP entities’ (S4 – COBA, S8 – BCCM, S9 – CAANZ, S3 – CPAA) . Conversely, only two respondents (S1 – Keith Reilly, S11 – KPMG) noted that the definition and guidance are sufficient, but nonetheless supported further guidance being made available.
- 15 Several respondents requested guidance and/or clarification regarding how to determine when an entity’s principal objective is not the generation of profit. In particular, respondents indicated the definition is proving problematic in the following circumstances:
- (a) some entities are interpreting the definition of ‘not-for-profit’ to mean that a not-for-profit entity cannot make any ‘profit’ or ‘surplus’ from operations, even when a profit would be designated to fund their future activities. Respondents (S10 – AICD, S2 – SWS, S3 – CPAA, S11 – KPMG) are of the view that being precluded from making this ‘profit’ or ‘surplus’ would lead to an entity being unsustainable;
 - (b) some entities, or groups of entities, are structured in such a way that different objectives exist within the entity – some objectives for the generation of profit and some for philanthropic purposes. For example, a social enterprise or a NFP parent

entity that has for-profit subsidiaries that are required to be consolidated would have a range of objectives. In these circumstances, determining the *principal* objective of an entity requires significant judgement and further guidance has been requested by some respondents (S3 – CPAA, S11 – KPMG, S6 – EY);

- (c) two respondents (S4 – COBA, S8 – BCCM) raised concerns about identifying whether entities set up as co-operatives and mutual enterprises (CMEs) would be appropriately classified as a for-profit or not-for-profit entity based on the current definitions. These respondents noted that these entities are often set up for the mutual benefit of members, rather than generating profit for a separate group of investors/shareholders. In some circumstances the benefit to members appears to arise through a profit/cost saving motive (for example, a customer owned banking institution) and therefore the users of financial statements would demand the information required by for-profit entities, whilst others are set up with a community benefit motive (for example, a sporting club) and the reporting requirements for not-for-profit entities would be more appropriately applied. These respondents want to ensure CMEs with users that demand the same information as for-profit entities, for example customer owned banking institutions, are not precluded from providing this information if they were to be classified as a not-for-profit entity; and
- (d) some entities in the public sector are designated as for-profit, however are monopoly providers and as such do not compete in the market, are price regulated, and/or have a significant cost associated with community service obligations that require subsidisation (S7 – ACAG).

16 One respondent (S6 – EY) suggested that the for-profit/not-for-profit distinction could be applied at the ‘activity’ level rather than for an ‘entity’ as a whole. For example, in a group that has both for-profit and not-for-profit activities, only those activities identified as not-for-profit would apply not-for-profit requirements. This respondent does however acknowledge the practical difficulties, and the effects on IFRS compliance for for-profit entities with not-for-profit activities.

17 A clear majority of respondents support the Board monitoring and, where appropriate, working with the New Zealand Accounting Standards Board (NZASB) on its project to update the definition of a public benefit entity (PBE).

18 Numerous respondents suggested the Board consider guidance available from external sources, including regulators and standard-setters in other jurisdictions. In particular, some respondents referenced the following literature:

- (a) three respondents (S4 – COBA, S5 – HoTARAC, S7 – ACAG), in addition to their support of following the NZASB’s definition of a PBE project, noted the potential usefulness of the current definition of a PBE:

Public Benefit Entity: *PBEs are reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective, rather than for a financial return to equity holders.*

Respondents preferred that the NZASB’s definition has a greater focus on the nature and purpose of a not-for-profit/public benefit entity, and appears to address the concerns regarding an NFP entity’s ability to make ‘profit’ noted in paragraph 15(a). The UK and NZ definitions of PBE are substantially the same;

- (b) two respondents (S4 – COBA, S10 – AICD) note that both the Australian Taxation Office (ATO) and the Australian Securities and Investments Commission (ASIC) refer to a not-for-profit entity as being “an organisation that is operating for its purpose and not for the profit or gain (either direct or indirect) of its individual members”; and
- (c) one respondent (S7 – ACAG) noted a 2010 Productivity Commission definition: “an organisation that imposes the non-distribution of profits to the members of the organisation”.

Staff recommendations

- 19 Respondents generally appear to have a clear vision of the characteristics that distinguish for-profit and not-for-profit entities, but are concerned that the AASB has not provided enough guidance to align their view of a not-for-profit entity with the definition of not-for-profit entity under Australian Accounting Standards.
- 20 Staff recommend that the AASB follows the NZASB’s project on improving guidance on the definition of PBE, and considers how the AASB can utilise this in creating its own guidance on applying the not-for-profit definition.
- 21 Staff consider that the Board need not redefine the term not-for-profit in Australian Accounting Standards, but instead clarify that judgement is necessary when determining the *primary* objective of an entity. Staff recommend that any such guidance should also clarify the interpretation of the definition in relation to issues raised by respondents.

SMC 3 Do you have any other comments on the AASB’s draft Standard-Setting Frameworks?

Special purpose financial statements

- 22 Four respondents (S1 – Keith Reilly, S3 – CPAA, S9 – CAANZ, S10 – AICD) commented on the assertion in ITC 37 that the AASB does not set standards for special purpose financial statements (SPFS). These respondents expressed the view that the AASB does set Standards for SPFS, given that AASB 1057 *Application of Australian Accounting Standards* paragraph 7 requires the application of certain Standards by all entities required to prepare financial reports in accordance with Part 2M.3 of the *Corporations Act 2001*, regardless of whether the entity is a reporting entity, ASIC requirements permit such financial reports to be SPFS.

Staff recommendation

- 23 Staff recommend this paragraph is amended to clarify that, whilst the AASB has the ability to set requirements for SPFS, it does not exercise this ability on the conceptual basis that special purpose financial statements are appropriate when the only users of the financial statements that exist can demand the information that they require, and it is therefore unnecessary for the AASB to prescribe such requirements.

Beyond financial reporting

- 24 One respondent (S7 – ACAG) noted that “a fundamental criticism of the general purpose financial statements of all public sector entities is that they tell us at best, how much was earned and how much was spent, but never how well the funds were spent toward achieving their public benefit purposes”. This respondent strongly supports the continuation of the

AASB's Reporting Service Performance Information project, specifically seeking non-financial/qualitative information on the performance of public sector entities. Acknowledging the *AASB and AUASB Strategy 2017-2021*, the respondent questioned how the frameworks in ITC 37 interact with the objective to 'influence initiatives to develop standards and guidance that meet user needs for external reporting beyond financial reporting'.

Staff recommendation

- 25 Staff recommend that the frameworks appropriately address the development of external reporting beyond financial reporting.

Approach to IPSASB and IFRS for SMEs

- 26 Two respondents (S7 – ACAG, S9 – CAANZ) questioned whether the frameworks adequately address the Board's approach to and consideration of alternate suites of Standards for certain types of entities, namely the IFRS for SMEs Standard for smaller entities, and the International Public Sector Accounting Standards (IPSAS) for public sector entities. One respondent commented that the not-for-profit framework should address the AASB's current policy assertion that IPSASs are expected, in due course, to become the most relevant and appropriate Standards for public sector not-for-profit entities.

Staff recommendation

- 27 Staff recommend that the framework is updated to better reflect the approach to IPSAS Standards.. A draft policy statement on this approach was commenced in 2017 and should be developed further in conjunction with the standard-setting frameworks.

Structure of ITC 37

- 28 Some respondents (S6 – EY, S9 – CAANZ, S10 – AICD) commented on the structure of ITC 37, and request that the Board revise and clarify aspects of the document including:
- (a) the objective of the frameworks – and whether one framework covering both for-profit and not-for-profit considerations is a better approach;
 - (b) whether the document is conveying a framework or operational procedures of the AASB;
 - (c) how the framework fits in the context of other AASB pronouncements;
 - (d) update/include cross references to the various concepts, policies and other references throughout the documents; and
 - (e) ensuring that the framework is presented in a logical, easy to understand and user-friendly manner.

Staff recommendation

- 29 Staff recommend that these comments be considered further in developing the frameworks.

Other comments

- 30 One respondent (S7 – ACAG) encourages the Board to commence its outreach on key public sector projects before the exposure draft stage of a proposal, and to include this as a point in the standard-setting framework.
- 31 One respondent (S5 – HoTARAC) noted that there are circumstances where there may be reasons for differences between the for-profit entities and Not-for-profit entities in disclosure, but not recognition and measurement. Another respondent (S10 – AICD) commented that the transaction neutrality policy is burdensome to NFP entities in some cases, and could be removed for a simpler reporting tier;
- 32 Three respondents (S3 – CPAA, S9 – CAANZ, S10 – AICD) noted that it may be more appropriate to finalise the standard-setting frameworks after the AASB’s Australian Financial Reporting Framework project is completed, given the substantial research being carried out into the appropriateness of the reporting framework as it presently exists.

Staff recommendations

- 33 Staff recommend that the Board note the above comments, but does not make any amendments to the standard-setting frameworks in relation to these comments at this time on the basis that the frameworks are intended to reflect the current approach of the Board. The frameworks could be revisited once the Financial Reporting Framework project is completed, which is a longer-term timeframe.

Questions for Board members

Do Board members agree with the staff recommendations? If not, what do Board members suggest for further developing the standard-setting frameworks?