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Ms Kris Peach
Chair
Australian Accounting Standards Board
PO Box 204
COLLINS STREET WEST VIC 8007

via email: standard@aasb.gov.au

Dear Kris

AASB Exposure Draft ED 291 *Not-for-Profit Entity Definition and Guidance*

Deloitte is pleased to respond to the proposals in the Australian Accounting Standards Board ('AASB' or 'Board') Exposure Draft ED 291 *Not-for-Profit Entity Definition and Guidance* (ED 291).

Overall, we support the Board's proposals in ED 291 as we believe it provides a clearer definition of not-for-profit ('NFP') entities and the implementation guidance contains helpful and practical considerations for entities to apply when assessing its classification.

We do have a number of comments on certain aspects of the proposals, including:

- We believe that further guidance is required on the determination of equity holders in the proposed definition and how this is applied in subscription-based or membership-based entities
- Inclusion of practical examples illustrating cases where NFP entities charge commercial rates (instead of no or nominal consideration) and how it might affect the not-for-profit classification
- Assessment of the benefits provided by membership entities and whether the benefits refer to the financial surplus generated by the entity or the services provided by the entity

While we acknowledge that the efforts in applying these proposals will vary among entities we believe that the proposals will result in the appropriate classification of NFP entities if the guidance is applied correctly.

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Our detailed responses to the specific and general matters for comment are included in the Appendix.

If you have any questions concerning our comments, please contact me at 03 9671 7349 or Maybelle Chia at 03 9671 7071.

Yours sincerely

Isabelle Lefevre
Partner

Deloitte.

APPENDIX: RESPONSE TO SPECIFIC QUESTIONS IN THE EXPOSURE DRAFT

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.**

   Yes – we agree with the replacement of the current definition of not-for-profit ('NFP') entity with the proposed definition as we believe that the proposed definition is clearer and provides a positive statement of what a NFP entity is (instead of what it is not – which is the nature of the current definition). We support the introduction of the proposed definition because it focuses on the nature and objectives of a NFP entity as well as contemplating the purpose of contributed equity. However, we believe that there should be further guidance on the determination of the equity holders in the proposed definition. In cases of subscription-based or membership-based entities, the members or subscribers are the parties who provide the necessary funds for the operations of the entity via the fees it pays and are the parties who essentially obtain the benefits through the operations of the entity but in essence, they are not considered to be equity holders as they do not contribute 'equity'. Accordingly, when assessing the second part of the proposed definition, we believe more guidance is necessary on the determination of equity holders and how this is applied in subscription-based or membership-based entities.

   Given the importance of correct classification of entities between for-profit and NFP (as this drives the appropriate recognition and measurement requirements of the relevant accounting standards) we believe that the proposed definition will result in more relevant consistency in the measurement, recognition and disclosure in financial statements as it will ensure that the appropriate reporting framework is applied to each entity's financial statements.

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.**

   Except as noted above regarding the need for further clarification on the determination of equity holders in the proposed definition, we agree with the proposed implementation guidance and illustrative examples as we believe they are helpful in applying the requirements in practice. However, we do have specific concerns regarding particular parts of the guidance as detailed below.

   Inclusion of practical examples illustrating cases where NFP entities charge commercial rates (instead of no or nominal consideration)

   While we agree with the focus of the NFP entity definition being on the primary objective of the entity that it provides goods or services for community or social benefits, we have noted some concerns in the guidance on the nature of the benefits provided by an entity. In particular, in cases where an entity charges commercial rates for its goods and services, we are concerned that this may result in the risk that that the entity incorrectly classifies itself as a for-profit entity even if its principal objective is to provide services for community or social benefits.

   In particular, we note that paragraph 21 of the implementation guidance states that 'if an entity provides goods or services to recipients at no cost or for nominal consideration, the entity is likely to be a NFP entity'.

   We also note that in 'Example 3: Private education organisation' of the illustrative examples, the background information states that Entity B provides low-cost high quality education to children who migrated to Australia from poverty-stricken countries and only accepts a limited number of fee-paying students in order to supplement its income. The entity is classified as NFP.

In Australia, there are many private schools that charge significantly higher school fees as compared to public (government) schools. When applying the above requirements in the implementation guidance and Example 3 of the illustrative examples, given that the private schools do not charge no or nominal consideration for their services nor do they provide education to disadvantaged students (such as the children who migrated to Australia from poverty-stricken countries in Example 3 above), we believe the guidance may be open to alternative interpretation in practice which might result in the private schools being classified as a for-profit entity despite their primary objective being to provide services for community or social benefits. That is the example is, in our view, too extreme without a contrasting example that better considers the basis of definition where the outcome is not so apparent. Accordingly, we believe, if the private schools do generate a financial surplus but these surpluses are then reinvested in the schools infrastructure (e.g. buildings, facilities etc.) to support the school's primary objective of providing goods or services for community or social benefit (education), in our view, the charging of commercial rates by private schools should not result in a for-profit entity classification.

Furthermore, we note that NFP entities which charge commercial fees are not limited to private educational organisations, they also extend to private hospitals and aged care facilities in the NFP sector.

In our opinion, it would be helpful to expand the implementation guidance or have an illustrative example for private organisations that charge commercial fees and are required or expected to use any surplus to support the entity's primary objective of providing goods or services for community or social benefit to illustrate this matter given its significance in the NFP sector.

Assessment of the benefits provided by membership entities and whether the benefits refer to the financial surplus generated by the entity or the services provided by the entity

Another concern we have is in regards to implementation guidance on the primary beneficiaries of the benefits in cases of membership based organisations.

We note that paragraph 28 of the implementation guidance states that 'if the entity is membership based and the primary beneficiaries of the benefits provided by the entity are not members of the entity, the entity is likely to be a NFP entity,' and 'if the primary beneficiaries are members of the entity, it is necessary to consider other factors to determine whether the entity is a NFP entity (for example, the nature of the benefits and other indicators in this guidance)'.

We believe that further guidance is needed on the consideration of the benefits as it may be open to interpretation as to whether the benefits refer to the financial surplus generated by the entity or the services provided by the entity. This also links back to our earlier comment to question 1 on the determination of equity holders in membership-based or subscription-based entities.

In many cases for NFP membership organisations, the primary beneficiaries are limited to their members. Some examples are the professional associations such as CPA Australia, Chartered Accountants Australia and New Zealand (CAANZ) and Institute of Public Accountants (IPA) – while such organisations do offer certain events that are open to public, generally, the beneficiaries of the goods (member-only publications) and services (member-only events and functions) are generally reserved for its members. This is also the case for other social membership organisations such as the Australia Club and the Alexandra Club where only members have access to their exclusive facilities.

However, such membership organisations are generally not set up to generate profit, instead, its primary objective is to provide goods or services for community or social benefits. Accordingly, we believe it may be beneficial to expand the implementation guidance to clarify that membership organisations with primary beneficiaries as its members does not preclude such entities from being classified as a NFP entity as long as its primary objective is to provide goods or services for community or social benefits.

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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?**

   Yes we agree that it is important to take into consideration the characteristics of the group and the controlling entity when determining the classification of a group.

   We agree that the classification of the controlling entity of the group would most likely determine the classification of the group. In particular, we believe 'Example 2: Bicycle Shop' in the illustrative examples is very helpful in this regard as it considers the pass through of the funds between the entities as well as the treatment of the net assets on wind up of the entity.

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?**

   We believe that there may be limited cases of entities that might change their classification on initial application of this guidance (e.g. a NFP classification assessment that was previously made at group level under the current NFP definition compared to NFP classification assessment that is now performed at the entity level under the proposals) and we agree with the proposals that in those scenarios, an entity will need to apply AASB 108 (or AASB 1053 if the entity's most recent financial statements did not contain an explicit and unreserved statement of compliance with Australian Accounting Standards) for any necessary accounting policy changes.

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.**

   Yes – we believe that the inclusion of the definition and associated guidance in AASB 1057 is the most appropriate approach.

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

   Yes – we believe the implementation guidance is helpful for entities in applying the requirements and accordingly, should form an integral part of AABS 1057 and have mandatory status.

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?**

   We agree these frameworks have been applied appropriately on the basis of the Board's rationale outlined in paragraphs BC2 to BC5 of the Basis for Conclusions.

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?**

   We have not identified any issues in addition to those outlined elsewhere in this letter.

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

    As noted in our introductory comments we believe that the proposed definition will result in more relevant consistency in the measurement, recognition and disclosure in financial statements as it will ensure that the appropriate reporting framework is applied to each entity's financial statements.

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

Given the proposals will result in a clearer definition of NFP entity, we believe the proposals should not be overly onerous and will result in an improvement in financial reporting in Australia. Accordingly, in our opinion the proposals are in the best interests of the Australian economy.

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.

Except as noted in question 1 regarding the need for further clarification on the determination of equity holders in the proposed definition, we do not consider the proposals would be overly onerous and accordingly, the costs of preparation are not expected to be significant.