PO Box 1411
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9 September 2019

Ms Kris Peach
Chair
Australian Accounting Standards Board
PO Box 204
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AUSTRALIA

Dear Kris

Exposure Draft 291 — Not-for-Profit Entity Definition and Guidance

I am pleased to make this submission on ED291.

I have over 30 years' experience in accounting advisory functions of large accounting and auditing firms across a wide range of clients, industries and issues in the for-profit, not-for-profit, private, and public sectors. My clients across the business and government environments have included listed companies, unlisted and private companies, charitable and not-for-profit organisations, commonwealth, state and local government departments and agencies in the public sector, and government owned corporations (government business enterprises).

I do not agree with the proposals to change the definition of not-for-profit entity as:

- the AASB has failed to provide evidence-based support for any change
- the change is not needed
- the costs for entities to reassess their classification and make any changes is unnecessary.

I detail below my responses to selected individual Exposure Draft Questions.

Yours sincerely

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Specific matters for comment

The AASB would particularly value comments on the following:

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.**

I do not agree the proposals to change the definition, as I do not believe that there is currently a problem.

The AASB states[1] that it uses an evidence-based approach to standard setting. However, for these proposals the AASB does not provide any evidence that there is a problem.

While there are differences between FP and NFP accounting, these are mainly related to NFP issues, such as donations, grants and contributions, and valuation of assets not held primarily to generate cash flows. The other major differences include different accounting for government capital grants (upfrontish for NFP, over time for FP), and offsetting asset revaluations (by class for NFP vs individual asset for FP).

While I found[2] diversity in application of the NFP / FP classification for member-based organisations as part of my response to ITC37 Invitation to Comment *The AASB's Standard-Setting Frameworks for For-Profit Entities and Not-for-Profit Entities*, it was not clear if a classification was "wrong" or not. When considering that diversity, I did not find significant consequences due to the low level of government capital grants and revaluations of PPE by entities classified as FP entities.

The reference by the AASB to possible future diversity in relation to a possible third tier of accounting is within the control of the AASB and would only arise because the AASB appears to be determined not to provide a simplified measurement and recognition tier for FP entities. A simplified tier for NFP entities should also be available for FP entities.

I do not agree with the characterisation of the current definition being a negative definition. Instead, I believe a residual characterisation would be more accurate.

Having two "positive" definitions means that some entities may meet both definitions, or neither. This will cause additional confusion and costs as the outcome is a binary classification – an entity must be FP or NFP.

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[1] For example, "AASB Academic Advisory Panel call for applications by 3 July 2019" https://www.aasb.gov.au/admin/file/content102/c3/AASB_AAP_Apps_0619.pdf

[2] http://www.aasb.gov.au/admin/file/content106/c2/ITC37_sub_12_David_Hardidge.pdf

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.

I found aspects of the guidance confusing. For example, the guidance seemed to imply that if an entity provides benefits primarily to a restricted group (say members) and not society as a whole, then the organisation would have characteristics of being for-profit. For example, paragraph 9, paragraphs 25 to 28. This would likely change the classification of many clubs and associations.

Another area of confusion was co-operatives that provide benefits to members through higher prices and rebates (paragraph 24). I note that based on my research for ITC37 that some co-operatives classify themselves as not-for-profit with no apparent detriment to users.

I did not find the remainder of the guidance particularly useful as the examples were inconclusive. The guidance is unlikely to reduce the current, though limited, diversity. As noted above, there does not appear to be significant consequences of such diversity.

I do not expect the guidance to assist in the classification of businesses classifying themselves as "social enterprises", or "profit for purpose" businesses. Even though there is a specific example for this type of entity, the guidance did not seem any more useful than what we currently already have.

Having a multitude of indicators, as proposed, is likely to cause problems in the future as companies get more into corporate social responsibility and virtue signalling. For example, the United States Business Roundtable statement of August 19, 2019[3]. Under these approaches companies aim to satisfy a multitude of stakeholders, not just shareholders. While stating that all stakeholders are essential, the Business Roundtable statement listed shareholders last in a list of five.

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?

I do not agree with the inclusion of the rebuttable presumption that the classification of the group is that of the parent entity.

The classification of the group should be based on the characteristics of that group.

In practice, I find that for groups with a combination of classifications, that there is a predominant classification – for example, whole of governments with some government-owned corporations / government business enterprises, or private sector for profit groups with a charitable foundation.

[3] Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'
https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans

I believe that the rebuttable presumption may cause problems with groups headed by a trust, for example a family trust where the family trust would often be arguably not-for-profit. For a hypothetical example, I would expect that the IKEA group (if it was Australian and produced a financial report) would be prepared on a FP basis, even though it is owned by a charitable foundation.

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?

The guidance is insufficient. The guidance should be more helpful in identifying differences that will need to be considered. Based on my work noted above these are:

- mainly related to NFP issues, such as donations, grants and contributions, and valuation of assets not held primarily to generate cash flows
- government capital grants (upfrontish for NFP, over time for FP)
- offsetting asset revaluations (by class for NFP vs individual asset for FP).

More recently, there are NFP differences with peppercorn leases, something predominately encountered by NFP entities.

5 No transition requirements have been proposed for the initial adoption of the guidance. Are initial transition provisions required, and if so, what should they state?

The main difference that I believe would cause implementation issues is if a NFP changes to FP and it had revalued assets. In these circumstances, the NFP would have determined the asset revaluation reserve (ARR) by class, and would have to change to accounting for the ARR by individual asset. Would the NFP have to recalculate the ARR by individual asset, keeping in mind that the ARR may also be attributable to assets previously owned and now sold or no longer in use.

Other than that difference there probably does not need to be any transition requirements, as the relevant differences between NFP and FP accounting are currently minimal and readlily identified – e.g. grants.

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.

I agree that moving the current definition of not-for-profit to AASB 1057 has merit.

I also believe that moving the definitions to AASB 1053 also has merit, as that standard deals with the reporting framework (Tier 1 and Tier 2) and moving tiers.

Of the two, I more frequently refer to AASB 1053 than AASB 1057.

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

I noted above areas of confusion. I also did not find the examples particularly useful. Therefore, I believe the guidance should not be mandatory.

General matters for comment

The AASB would also particularly value comments on the following general matters:

8 Whether *The AASB's Not-for-Profit Entity Standard-Setting Framework* has been applied appropriately in developing the proposals in this Exposure Draft?

No, I do not believe that the framework has been appropriately applied, as the AASB has not provided any evidence that there is currently a problem. The consequences of issuing the proposals will be unnecessary costs incurred by organisations, with no demonstrated benefit.

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?

I make no comment.

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

No, I do not believe there would be an improvement, as there does not appear to be a problem in the first place.

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

No, the proposals are not in the best interests of the Australian economy.

The proposals are not needed. The proposals will impose an unnecessary burden on entities to have to assess the implications of the change. It is likely that auditors will require their clients to prepare a position paper on the change. There seems little point in going through this exercise if there is no current problem, and little change in the accounting.

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.

As I have noted above, I believe there is no need for the change, and introducing the change would introduce unnecessary costs and would not be in the best interests of the Australian economy.