



Australian Government



Australian
Charities and
Not-for-profits
Commission

4 September 2019

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

Our reference: EXT2019/89

Dear Ms Peach

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

The Australian Charities and Not-for-profits Commission (**ACNC**) welcomes the opportunity to comment on Exposure Draft 291 – **Not-for-Profit Entity Definition and Guidance (ED 291)**. We provide this letter which includes general comments and attached appendix in which we address the specific questions raised by the AASB.

The ACNC is the national regulator for charities with a focus on the following key statutory objectives. These legislated objectives are outlined in s 15-5(1) of the *Australian Charities and Not-for-Profits Commission Act 2012 (Cth)* (**ACNC Act**) and require the ACNC to:

- maintain, protect and enhance public trust and confidence in the Australian not-for-profit (NFP) sector;
- support and sustain a robust, vibrant, independent and innovative Australian NFP sector; and
- promote the reduction of unnecessary regulatory obligations on the Australian NFP sector.

The ACNC maintains a free and searchable online public register of charities (**the Charity Register**). The Charity Register helps the public to understand the work of the charity sector and enables charities to be transparent by publishing information about their governance, activities, operations, and finances.

The ACNC regulates over 57,000 charities in Australia which are a sub-sector of the NFP sector. It is with regard to the impact of the proposed change on the charities sub-sector within which we frame our response. [ACNC Commissioner's Policy Statement 2017/04: Financial reporting scaffolding policy](#) guides ACNC participation in dialogue about financial reporting.





The ACNC supports a financial reporting framework that is proportionate, fit for purpose, meets the needs of users and minimises administrative burden on charities. However, the potential for some charities to be classified as a for-profit (FP) entity based on the ED is problematic and we do not support this for the following reasons:

- there is no evidence from users that requires a charity to use a FP reporting framework, nor is there any cost/benefit analysis where the benefits for a charity to prepare FP financial reports outweigh the cost
- it will cause unnecessary confusion to the public that charities on the ACNC Charity Register may be required to prepare financial reports using the FP reporting framework
- it may result in possible reputation/perception risks that charities prepare FP financial reports especially where the general public do not have the technical understanding of the financial reports
- it clashes with the key elements in the Australian federal legal definition of charities
- it will impose reporting impost and administrative burden that any charity classified as a FP entity will have to early adopt the revised Conceptual Framework to prepare general purpose financial statements (GPFS)
- any benefits should a NFP reporting framework be developed that is fit-for-purpose with simplified recognition and measurement requirements will not cover those charities that are classified as a FP entity.

The ACNC estimates that over 300 registered charities will be impacted by the proposed definition due to their size and legal structure being proprietary companies with equity holders that are also registered charities. To avoid any additional burden or interpretative confusion, the ACNC suggests adding a definitive statement or a significant indicator as an overall assessment that all ACNC registered charities shall be classified as NFP entities within the implementation guidance to alleviate any potential interpretation to the contrary.

We understand the definition is solely to determine the financial reporting framework for the preparation of financial statements. As charities are a sub-set of NFPs, it is important to ensure the application of the proposed definition aligns with the Australian federal legal definition of charity¹. The AASB may also consider the ACNC's paper regarding '*A Common Charity Definition?*'² that proposed a single definition to make all charity determinations across all states and territories.

The attached appendix provides the ACNC's detailed response to the Specific Matters for Comment as set out in ED 291. Please note that these responses focus on the perspective of NFP private sector entities which are ACNC registered charities.

¹ Section 5 of the *Charities Act 2013* (Cth) (Charities Act) contains the definition of 'charity' for Commonwealth law. The definition of charity similarly requires all of an entity's purposes to be 'charitable purposes' (as defined under section 12 of the Charities Act) for the public benefit, with any other purpose only being incidental or ancillary and in furtherance or in aid of the charitable purpose(s).

² <https://www.acnc.gov.au/media/news/benefits-single-definition-charity>



Please do not hesitate to contact Mel Yates, at Melville.Yates@acnc.gov.au or 03 927 59595 should you have any queries in relation to the above.

Sincerely,

A handwritten signature in black ink, appearing to read 'Gary Johns', is positioned below the word 'Sincerely,'. The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Dr Gary Johns
Commissioner
Australian Charities and Not-for-profits Commission

Enc:
Appendix – Response to Specific and General matters for Comment



Appendix – Response to Specific Matters for Comment – ED 291

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?*

The ACNC agrees that the current definition of NFP entity in Australian Accounting Standards should be replaced and generally agrees with the proposed definition that is based on the New Zealand definition of public benefit entity.

The proposals in the ED improves the current definition to reflect that generation of profits is a key financial viability element for many charities to enable the continuous operation and allow the profits to be applied for charitable purposes.

The proposed definition appears to be broad enough to cover all registered charities and is generally appropriate for the new definition to be used in the Australian standard-setting framework. However, there are concerns when the definition is read in conjunction with the implementation guidance as explained in our response to Q2.

2. *Do you agree with the proposed implementation guidance and illustrative examples?*

The proposed NFP definition, based on the wording in isolation, appears sufficiently broad to include all charities registered with the ACNC. However, the proposed implementation guidance does suggest it would be interpreted in a more restrictive fashion resulting in some registered charities to be classified as a FP entity for the purposes of financial reporting. The ACNC suggests that AASB should ensure that all registered charities are captured by the new definition and that the guidance should make this clear.

The ACNC has a concern over paragraph 5 under the heading 'Definition of a NFP entity' where it raises the possibility that a charity registered with the ACNC can be classified as a FP entity for financial reporting purposes. This could result in these charities no longer being able to apply NFP related accounting standards (e.g. AASB 1058 *Income of Not-For-Profit Entities*) that better reflects the economic substance to account for specific transactions. They will be subject to a more rigorous FP framework and ineligible to any simplified recognition and measurement requirements for NFP entities should a new reporting tier be developed.

Therefore, the ACNC suggests the inclusion of a definitive statement or a significant indicator as part of paragraph 12 of the Appendix to the ED stating that ACNC registered charities should be classified as a NFP entity to alleviate any potential interpretation to the contrary.

One of our considerations relates to the users of the ACNC's Charity Register. From a user's perspective, having FP and NFP financial statements on the Charity Register may confuse the public and potentially impact the comparability of those financial statements. The users of FP financial statements (if to be prepared by a registered charity) are likely to be the same users as other charities preparing NFP financial statements. To date the ACNC has not received any



concerns from the public, nor have we identified through our regulatory approach that specific charities should prepare financial statements under a FP financial reporting framework.

Another concern relates to Illustrative example 2: Bicycle shop. The proposed definition has two limbs, one refers to a primary purpose of providing goods or services for social benefit, and the other is with equity only provided to support that primary purpose. The definition of 'charity' under the Charities Act for the purposes of Commonwealth law similarly requires a 'charity' to operate for solely charitable purposes for the public benefit, with any other purpose only being incidental or ancillary and in furtherance or in aid of the charitable purpose(s).

In that scenario, the proposed guidance suggests that if 'Company 1' operates a bike shop to raise funds to support a charitable trust, it would be treated as a FP entity, even if all surpluses went to the charitable trust. This is contrary to the legal position in Australia where a business operating to raise funds to solely put toward a charitable purpose, that business has a charitable purpose even if the business itself is not of a charitable nature.

We recommend that the guidance referring to the Nature of equity interest (at page 17), be amended to state that when all equity holders of an entity which is an ACNC registered charity are also registered charities, the entity generating a financial benefit solely for such equity holders will be a NFP entity.

In relation to Purpose and use of assets (paragraphs 31 and 32), it is suggested that a FP entity generally hold assets mainly for sale or for generating a financial benefit for equity holders. However, this circumstance may also be applicable for philanthropic trusts which generally hold assets mainly for sale or to generate profit in order to make grants to NFP organisations. We recommend adding an additional NFP entity example to clarify that charitable trusts are NFP entities that hold donated assets on trust and make distributions for charitable purpose for the public benefit.

3. *Do you agree that in determining the classification of a group that 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?*

We believe the classification of a group would most likely be determined by the characteristics of the controlling entity given where consolidated financial statements are prepared, the financial reporting framework would be based on the classification of the controlling entity. Based on the ACNC's Charity Register, there are some charities at the parent entity level that control a FP entity (not registered with the ACNC). In that scenario, we would accept the charity's consolidated financial statements, if required by the Australian Accounting Standards, using the NFP financial reporting framework. This will ensure consistent application of the NFP financial reporting requirements are being applied across all registered charities.



4. *Do you agree with the proposed guidance on the accounting consequence for an entity that changes its classification as a for-profit entity or a not-for-profit entity? Is this guidance sufficient?*

The proposed guidance on the accounting consequence for a registered charity to change its classification from a NPF to a FP entity is not a realistic scenario as it will impact the status of the charity. The ACNC would see any circumstantial change to the indicators such as their stated objective, the nature of their equity interest or purpose and use of assets as a compliance issue which may affect the entity's charity registration status. The only indicator that may not impact on a charity to remain registered with the ACNC would be a change to their business model from relying solely on grants and donations to a social enterprise business model.

From the ACNC's perspective, while a charity retains its ACNC registration status, the definition of 'charity' in the Charities Act requires a charity to be a NFP entity and all assets and income of a charity shall be applied solely to further its charitable objects. Hence it may give rise to compliance concerns of entitlement as a registered charity, when a charity changes its classification to a FP entity based on the indicators outlined in paragraph 12 Appendix B to the ED even though it is for the purpose of financial reporting.

If our suggested recommendations in Q2 are not adopted, then where the circumstance arises that an entity changes its classification, for example, an entity is granted charity registration or a charity ceased to be registered with the ACNC, we are of the view that any necessary accounting policy changes subject to AASB 108 and any transitional requirements in other AASB standards are sufficient at this stage.

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

If our recommendations in Q2 are not adopted, we would recommend that initial transitional provisions be provided for charities that change classification to a FP entity due to the proposed new definition, as these charities will be unable to apply NFP specific accounting standards. There is also a major impact for any registered charities classified as a FP entity which will have to prepare GPFS at the same time as FP private sector entities if the AASB's proposal to remove special purpose financial statements for FP private sector entities is implemented.

6. *Do you agree that the definition and associated guidance should be included in AASB 1057 Application of Australian Accounting Standards?*

Yes, we think it should be included in AASB 1057 Application of Australian Accounting Standards noting that it will not be applicable for charities preparing special purpose financial statements.



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

The ACNC agrees that the implementation guidance should be part of AASB 1057 with a mandatory status. This suggestion is put forward while balancing the following considerations. On one hand, mandatory requirements will provide clarity and consistency, encouraging uptake by all registered charities when assessing the relevant financial reporting framework. On the other hand, the ACNC has a legislative object to promote the reduction of unnecessary regulatory obligations on the Australian NFP sector. In weighing up the benefits that may also include future benefits in longer term (e.g. simplified recognition and measurement, more fit-for-purpose reporting and specific reporting exemptions that are available only to NFP entities), against the costs (expecting few charities to experience difficulties in applying the new definition), the overall benefits outweigh the costs.

Response to 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?*

The ACNC believes The AASB's Not-for-Profit Entity Standard-Setting Framework has been applied appropriately. A clear definition of NFP entity will help to implement a simplified recognition and measurement reporting framework that can potentially benefit all registered charities if a further reporting tier is to be developed.

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 Financial Statistics (GFS) implications?*

As outlined in our response to Specified Matter Q2, to avoid any unnecessary reporting burden and address a potential clash between the Charities Act's definition of a charity and the NFP Entity definition proposed, the ACNC would recommend the AASB to consider our suggestion made in the Specified Matter Q2.

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

The ACNC does not support the proposals that a registered charity may be classified as a FP entity nor do we believe financial reports prepared using the FP reporting framework would be more useful than those prepared under a NFP reporting framework. We have not received any feedback from users to require charities to use the FP reporting framework nor is there a cost/benefit analysis that support charities to prepare FP financial reports outweighing the costs in preparing them. Furthermore, charities that are captured in the FP framework as a result of the proposals will have an earlier implementation date to prepare GPFS due to the revised Conceptual Framework for FP entities.



If the ACNC's recommendations are not adopted, it would be useful if NFP entities that determined themselves as a FP entity for reporting purposes disclose which indicators, as outlined in paragraph 12 of Appendix B to the ED, they have applied in making that assessment.

The ACNC sees value to continue our dialogue with the AASB and the NFP sector to support improving the financial reporting framework. The proposals in the ED would become increasingly more important for a charity to distinguish between a FP and NFP entity should a new reporting tier be developed with simplified recognition and measurement requirements.

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

The ACNC considers the proposals are in the best interest of the Australian economy to provide a positive statement about what a NFP entity actually is. The proposal will drive focus on their charitable nature and purpose being committed to the public benefit.

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.*

The ACNC has received some concerns from our stakeholders that the proposals could create inconsistency in the application due to the judgement required in considering the indicators. If our recommendations were not adopted, we estimate that over 300 charities will be impacted by the proposals and we believe that it will impose reporting impost and administrative burden for those affected charities. We also anticipate that there may be some administrative cost if charities engage professional advisors to help them consider and assess the indicators in the proposals.