



## PROPOSED AMENDMENT TO NOT-FOR-PROFIT ENTITY DEFINITION WHAT DOES IT MEAN FOR CO-OPERATIVES & MUTUALS?

### Background

As part of the consultation undertaken in relation to the AASB's standard-setting frameworks in 2017, the AASB asked for specific feedback regarding the definition of a Not-for-Profit (NFP) entity, and whether there was sufficient guidance on how to distinguish entities as For-Profit (FP) entities and NFP entities.

The majority of respondents supported retaining the term 'not-for-profit entity', but requested more guidance from the AASB in determining whether an entity is a FP or NFP entity under the accounting standards.

The [AASB released Exposure Draft \(ED\) 291 Not-For-Profit Entity Definition & Guidance](#) in June 2019 for comment by 9 September 2019.

### Proposed Definition of a NFP

The current definition of a NFP as defined in Australian Accounting Standard 102 Inventories 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.*

The proposed definition for a NFP is as follows:

*An entity 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 beneficial return to equity holders.*

The proposed definition comprises two interdependent parts:

- i) the primary objective to provide goods or services for community or social benefit, and
- ii) the provision of equity to support that primary objective rather than for a financial return to equity holders.

Both parts of the definition need to be assessed in combination when determining an entity's classification.

The classification of whether an organisation is a NFP is made at the entity level and does not consider the classification of a controlling entity or the entities it controls. As a result, the classification at the entity level may differ from the classification at the group level. In determining the classification of a group, it is necessary to consider the characteristics of the group. The classification of the controlling entity in the group would most likely determine the classification of the group.

### Why is the Change to the Definition Important to Co-operatives & Mutuals

The classification of an entity as a FP or NFP determines which accounting standards and related accounting policies are applied to the financial reporting of the entity or group. At present, the Australian Accounting Standards incorporate unique financial reporting requirements / exemptions for NFP's which differ from those to be adopted by for-profit entities. This means that your financial reporting practices and disclosures will change if the classification of your entity or entities changes from NFP to FP or vice-versa.

### How Do You Determine Whether Your Entity is a NFP?

In some cases, determining the primary objective of an entity can be difficult where it has multiple objectives and such objectives are not ranked. To identify your organisation's primary objective it will be necessary to assess the substance of the entity's purpose. Professional judgement may be required and the organisation's constitution may require amendment to ensure classification as FP or NFP can be supported.

The Exposure Draft provides several indicators which should be considered when determining if your entity

or group meets the new definition of a NFP. Remember, substance over form and professional judgment will be required when assessing whether your entity is a NFP entity.

The indicators listed in the Exposure Draft are:

- the stated entity objectives;
- the nature of the benefits, including the quantum of expected financial benefits;
- the primary beneficiaries of the benefits;
- the nature of any equity interest;
- the purpose and use of assets; and
- the nature of funding.

The Exposure Draft provides comprehensive guidance on each of the above indicators which need to be assessed overall and in combination with each other.

#### How Should You Prepare For Possible Adoption of the Exposure Draft?

It would be prudent to assess the application of the proposed change to the definition of a NFP entity to your entity and / or group as follows:

1. if your entity or group is currently classified as NFP, assess and understand why it is classified as such and identify the not for profit exemptions it is currently entitled to under Australian Accounting Standards.

2. prepare a position paper which documents your assessment as a NFP or FP using the indicators and related guidance in the Exposure Draft.

If you conclude that the classification of your entity or group will change:

1. consider and document the material impacts on your financial report, and
2. consider the amendments to your accounting policies which may be required.

Your position paper should be presented to your Audit Committee or Board so they are aware of material impacts. They may wish for you to prepare a response to the AASB on the Exposure Draft prior to 9 September.

#### Conclusion

Membership based organisations such as co- operatives and mutuals will need to carefully consider the application of the proposed definition change.

In particular, those organisations that are currently considered to be NFP will need to apply considerable judgement and professional interpretation to ensure a possible reclassification to FP is identified early.