



EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

Exposure Draft

2018 Amendments to XRB A1 Appendix A

Invitation to Comment

December 2018

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New Zealand
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Information for respondents

Invitation to Comment

The External Reporting Board is seeking comments on the specific matters raised in this Invitation to Comment. We will consider all comments before finalising the *2018 Amendments to XRB A1 Appendix A*.

If you want to comment, please supplement your opinions with detailed comments, whether supportive or critical of the proposals, as both supportive and critical comments are essential to a balanced view.

Comments are most useful if they indicate the specific paragraph to which they relate, contain a clear rationale and, where applicable, provide a suggestion for an alternative. Feel free to provide comments only for those questions, or issues that are relevant to you.

Submissions should be sent to:

Chief Executive
External Reporting Board
PO Box 11250
Manners St Central
Wellington 6142
New Zealand
Email: submissions@xrb.govt.nz
(please refer to *2018 Amendments to XRB A1 Appendix A* in the subject line)

We would appreciate receiving a copy of your submission in electronic form (preferably Microsoft Word format) as that helps us to efficiently collate and analyse comments.

Please note in your submission on whose behalf the submission is being made (for example, own behalf, a group of people, or an entity).

The closing date for submissions is **Friday 29 March 2019**.

Publication of Submissions, the Official Information Act and the Privacy Act

We intend publishing all submissions on the XRB website (xrb.govt.nz), unless the submission may be defamatory. If you have any objection to publication of your submission, we will not publish it on the internet. However, it will remain subject to the Official Information Act 1982 and, therefore, it may be released in part or in full. The Privacy Act 1993 also applies.

If you have an objection to the release of any information contained in your submission, we would appreciate you identifying the parts of your submission to be withheld, and the grounds under the Official Information Act 1982 for doing so (e.g. that it would be likely to unfairly prejudice the commercial position of the person providing the information).

List of abbreviations

The following abbreviations are used in this Invitation to Comment.

ED	Exposure draft
GPFR	General purpose financial report
PBE	Public benefit entity
XRB	External Reporting Board
XRB A1	External Reporting Board Standard A1 <i>Application of the Accounting Standards Framework</i>

Questions for respondents

Paragraph(s)

- | | | |
|---|---|------|
| 1 | Do you agree with the proposed amendments to XRB A1 Appendix A
<i>When is an Entity a Public Benefit Entity?</i>
If you disagree, please provide reasons. | 9–24 |
| 2 | Do you agree with the proposed effective date of 1 January 2020?
If you disagree, please provide reasons. | 25 |
| 3 | Do you have any other comments on the ED? | – |

1. Introduction

1.1 Background

1. This Invitation to Comment and accompanying Exposure Draft (ED) proposes amendments to Appendix A of XRB A1 *Application of the Accounting Standards Framework*. The title of Appendix A is *When is an Entity a Public Benefit Entity?*
2. Appendix A provides guidance to assist an entity that prepares a general purpose financial report (GPFR) that complies with accounting standards issued by the External Reporting Board (XRB) to determine whether it is a public benefit entity (PBE) or a for-profit entity.
3. The classification of an entity as a PBE or for-profit entity is important to enable an entity to apply the appropriate accounting standards and associated accounting policies.
4. The changes to Appendix A are being proposed because:
 - (a) some of the guidance in Appendix A was based on guidance that existed prior to the development and issuance of the New Zealand Accounting Standards Framework and, now that this Framework has been operational for some time, it is appropriate to review the guidance; and
 - (b) some constituents have experienced difficulties applying Appendix A.

1.2 Purpose of this Invitation to Comment

5. The purpose of this Invitation to Comment is to seek comments on the proposed amendments set out in the ED.

1.3 Timeline and next steps

6. Submissions on the ED are due by Friday 29 March 2019. Information on how to make a submission is provided on page 4 of this Invitation to Comment.
7. After the consultation period ends, we will consider the submissions received, and subject to the comments in those submissions, we expect to finalise these amendments soon afterwards.

2. Overview of Invitation to Comment and ED

2.1 Summary

8. This Invitation to Comment seeks feedback on proposed amendments to Appendix A of XRB A1.

2.2 Approach taken in developing the ED

9. The changes to Appendix A, as proposed in the ED, are set out below.

Definition of a PBE

10. The guidance on the definition of a PBE now clarifies that the definition comprises two interdependent parts:
 - (a) the primary objective to provide goods or services for community or social benefit; and
 - (b) the provision of equity to support that primary objective rather than for a return to equity holders.
11. The ED clarifies that both parts of the definition need to be assessed in combination when determining an entity's classification (paragraph 8 of the ED).
12. The ED also clarifies that an entity could be classified as a for-profit entity for financial reporting purposes but could also be a registered charity (paragraph 6 of the ED).
13. The Appendix sets out several indicators to be considered in determining whether an entity meets the definition of a PBE. The ED acknowledges that in many cases it will be unlikely that any one indicator will be conclusive in determining whether an entity meets the definition of a PBE and it may be necessary to consider several indicators together. Professional judgement is required when considering and balancing the assessment of each indicator (paragraph 11 of the ED).
14. The ED clarifies that the classification of an entity as a PBE or a for-profit entity for financial reporting purposes is made at the reporting entity level. Therefore, when an entity is a subsidiary of another entity and the subsidiary is a reporting entity with its own reporting obligations, the subsidiary assesses its own primary objective for financial reporting purposes (paragraph 12 of the ED).
15. The ED states that in determining the classification of a group for financial reporting purposes, it is necessary to consider the characteristics of the group. The ED also states that the classification of the controlling entity of the group would most likely determine the classification of the group. (paragraph 12 of the ED).

Indicators

16. The indicators in the original Appendix A have been retained, subject to some changes which are explained below.

Stated objectives

17. 'Stated objectives' replaces the indicator previously titled 'Founding documents'. However, the guidance continues to include a reference to founding documents. There is new guidance to indicate that where an entity has multiple objectives, consideration of how the entity assesses its performance might be useful (paragraph 19 of the ED).

Nature of the benefits, including the quantum of expected financial benefits

18. ‘Nature of the benefits, including the quantum of expected financial benefits’ (paragraphs 21–25 of the ED) comprises two previously separate indicators that have been merged. This indicator also includes a discussion on the different forms of financial benefits (besides dividends).

Primary beneficiaries of the benefits

19. This is a new indicator (paragraphs 26–29 of the ED). It has been developed because an understanding of who the primary beneficiaries of the benefits provided by the entity are (i.e. the people who primarily benefit from the activities of the entity) assists in determining whether the entity is a PBE or a for-profit entity.

Purpose and use of assets

20. This is also a new indicator (paragraphs 32–33 of the ED). It has been developed because the reasons an entity acquires and/or holds assets may indicate whether an entity is a PBE or a for-profit entity. The proposed guidance contrasts the reasons why PBEs often hold and use assets compared to the holding and use of assets by for-profit entities.

Nature of funding

21. Guidance has been added to contrast the nature of funding provided to PBEs compared with the funding provided to for-profit entities.

Conflicting indicators

22. This section has been expanded to explain that professional judgement is required to evaluate the indicators overall and in combination with each other. Judgement is required to assess the significance of particular indicators to the overall assessment to determine whether, in substance, the entity meets the definition of a PBE (paragraph 38 of the ED).

Changing classification

23. This section now refers to the relevant paragraphs in XRB A1 for determining the applicable tier of financial reporting when an entity changes its classification from a for-profit entity to a PBE (or vice versa) (paragraph 40 of the ED).

Illustrative examples

24. The illustrative examples have been updated and a new example has been added.

Question for respondents

1. Do you agree with the proposed amendments to XRB A1 Appendix A *When is an Entity a Public Benefit Entity?* If you disagree, please explain why.

2.3 Effective date

25. Subject to consideration of the comments received on this ED, the XRB intends to finalise the amending standard in 2019 with an effective date of 1 January 2020 (with earlier application permitted).

Questions for respondents

2. Do you agree with the proposed effective date of 1 January 2020? If you disagree, please explain why?
3. Do you have any other comments on the ED?



EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

EXPOSURE DRAFT

2018 AMENDMENTS TO XRB A1 APPENDIX A

This [draft]¹ Standard was issued on [date] by the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This [draft] Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on [date].

Reporting entities that are subject to this [draft] Standard are required to apply it in accordance with the effective date, which is set out in Part D.

In finalising this [draft] Standard, the New Zealand Accounting Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This [draft] Standard has been issued to update and improve the guidance in Appendix A of XRB A1 *Application of the Accounting Standards Framework*. The title of Appendix A is *When is an Entity a Public Benefit Entity?*

¹ References to “this Standard” throughout this Exposure Draft should be read as referring to “this draft Standard”.

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ISBN

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Part A: Introduction

This [draft] Standard includes amendments to:

- (a) the guidance on the definition of a PBE to clarify that:
 - (i) the definition contains two interdependent parts and both parts of the PBE definition need to be assessed when determining an entity's classification;
 - (ii) the classification as a PBE or for-profit entity is made at the entity level. As a result, the classification at the entity level may differ from the classification at the group level; and
 - (iii) it is possible for an entity to be classified as a for-profit entity for financial reporting purposes and to be a registered charity.
- (b) the indicators to be considered in determining whether an entity is a PBE. Specifically:
 - (i) 'stated objectives' replaces 'founding documents' but includes reference to founding documents;
 - (ii) guidance is added on consideration of the entity's assessment of performance where an entity has multiple objectives;
 - (iii) 'Nature of the benefits, including the quantum of expected financial benefits' now includes the principles previously described under both the 'Nature of the benefits' and the 'Quantum of expected financial surplus' (now deleted) indicators;
 - (iv) a new indicator 'Primary beneficiaries of the benefits' has been added;
 - (v) a new indicator 'Purpose and use of assets' has been added; and
 - (vi) the 'Nature of funding' indicator includes more guidance.
- (c) the paragraphs on conflicting indicators have been expanded to explain that professional judgement is required to evaluate the indicators overall and in combination with each other, including the significance of particular indicators to the overall assessment.
- (d) the paragraphs under 'Changing classification' now refer back to relevant paragraphs in XRB A1 *Application of the Accounting Standards Framework* for determining the applicable tier of financial reporting when an entity changes its classification.
- (e) the illustrative examples have been updated and a new one has been added.

Part B: Scope

This Standard applies to entities that prepare, or opt under an enactment to prepare, GPFR in accordance with accounting standards issued by the XRB.

Part C: Amendments to XRB A1 Appendix A *When is an Entity a Public Benefit Entity?*

Appendix A is replaced as shown below. The references in square brackets ([...]) are to the relevant paragraph in existing Appendix A of XRB A1 or are shown as 'new'. The references have been included to assist readers with an understanding of the extent of the changes made to the existing Appendix A and will be removed when the amendments are finalised.

APPENDIX A

WHEN IS AN ENTITY A PUBLIC BENEFIT ENTITY?

This appendix forms an integral part of XRB A1 Application of the Accounting Standards Framework.

Purpose

- 1 The purpose of this Appendix is to assist an entity that prepares a general purpose financial report (GPFR) that complies with accounting standards issued by the External Reporting Board (XRB) to determine whether or not it is a public benefit entity (PBE). [based on paragraph 6]
- 2 The classification of an entity as a for-profit entity or a PBE is important because it determines which accounting standards and related accounting policies are applied by an entity. Inappropriate classification may result in the adoption of inappropriate accounting policies, and a failure to provide users with information appropriate to assessing the financial performance, financial position and service performance of an entity. [based on paragraph 7]

Definition of a PBE

- 3 XRB A1 defines PBEs as “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.” PBEs may be public sector entities or not-for-profit entities. [based on paragraph 2]
- 4 The following definitions for public sector PBEs and not-for-profit PBEs are contained in XRB A1:
 - (a) Public sector PBEs are PBEs that are public entities as defined in the Public Audit Act 2001, and all Offices of Parliament; and
 - (b) Not-for-profit PBEs are PBEs that are not public sector PBEs.[new]
- 5 For-profit entities are not defined. Rather, the term for-profit entities encompasses all entities other than PBEs. An entity must assess whether it is a PBE or a for-profit entity by considering whether or not it meets the definition of a PBE. Assessing whether an entity meets the definition of a PBE requires an entity to determine its primary objective. [based on paragraph 3]
- 6 In many cases it will be obvious whether an entity meets the definition of a PBE. For example, most charities registered under charities legislation are likely to meet the definition of a PBE although it is possible for a registered charity to be classified as a for-profit entity for financial reporting purposes. Similarly, many public sector entities operate under legislation that specifically requires them to provide goods or services for the benefit of the public. For example, the New Zealand Public Health and Disability Act 2000 requires this for District Health Boards. [first sentence from paragraph 10; then new]
- 7 In other cases it will not be immediately obvious that an entity is a PBE. Determining the primary objective of the entity (i.e. why the entity exists and what it intends to achieve) can be difficult where an entity has

multiple objectives and such objectives are not ranked, or where the objectives are not clearly stated. In identifying the primary objective, it is necessary to assess the substance of the entity's purpose. [based on paragraph 10]

- 8 In this regard, it should be noted that the definition of a PBE comprises two interdependent parts: (i) the primary objective to provide goods or services for community or social benefit, and (ii) the provision of any equity is 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 in determining an entity's classification. Assessing one of the parts alone is unlikely to be sufficient in determining whether an entity is a PBE or a for-profit entity. [new]
- 9 The legal form of an entity is unlikely to be a conclusive factor in determining whether or not an entity is a PBE. PBEs are constituted in many different forms such as incorporated societies, trusts, statutory bodies and even companies. PBEs include a wide range of entity types, including charities, clubs, and non-commercial public sector entities. They exist in the private sector and in the public sector and may be small or large. [based on paragraph 4]
- 10 Also, although in general terms PBEs exist to provide goods and services for the community or social benefit, this does not necessarily imply that such entities exist for the benefit of the public as a whole. Many PBEs exist for the direct benefit of a particular group of people, although it is also possible that society as a whole benefits indirectly. For example, a community football club exists to promote and encourage football for the direct benefit of its members. However, society as a whole may also benefit indirectly through a healthier population and through the provision of organised activities for its youth. [based on paragraph 9]
- 11 This Appendix sets out several indicators to be considered in determining whether an entity meets the definition of a PBE. In many cases it will be unlikely that any one indicator will be conclusive in determining whether an entity meets the definition of a PBE and it may be necessary to consider several indicators together. Professional judgement is required when considering and balancing the assessment of each indicator. [new]
- 12 The assessment for classification as a PBE or as a for-profit entity is made at the reporting entity level. As a result, the classification at the reporting entity level may differ from the classification at the group level. Therefore, where an entity is a subsidiary of another entity and the subsidiary entity is a reporting entity with its own reporting obligations, the subsidiary assesses its own primary objective for reporting purposes. In determining the classification of a group, it is necessary to consider the characteristics of the group. The classification of the controlling entity of the group would most likely determine the classification of the group. [new]

Indicators

- 13 Paragraphs 14 to 37 discuss key indicators that aim to focus on the substance of an entity's purpose and which should be considered in determining whether an entity is a PBE. These indicators are:
- the stated 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.

[based on paragraph 11]

Stated objectives

- 14 In many cases the governing legislation, a constitution, a trust deed, or other founding documents will specify the objectives of an entity, including for whom the benefits generated by the entity are intended. For example, the State-Owned Enterprises Act 1986 states that the principal objective of every State enterprise is to "operate as a successful business and to this end, to be:
- (a) as profitable and efficient as comparable businesses that are not owned by the Crown; and

- (b) a good employer; and
- (c) an organisation that exhibits a sense of social responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate or encourage these when able to do so.”².

[based on paragraph 12]

- 15 The founding documents of an entity may also specify the objective of an entity in terms of the nature of the benefits the entity provides. For example, one of the objectives of District Health Boards is to improve, promote and protect the health of people and communities. [paragraph 13]
- 16 In the not-for-profit sector, the meaning of charitable purpose is set out in the Charities Act 2005. In that Act, “charitable purpose includes every charitable purpose, whether it relates to the relief of poverty, the advancement of education or religion, or any other matter beneficial to the community.”³ [new]
- 17 Many entities are established with multiple objectives. For example, Crown Research Institutes (CRIs) are required by the Crown Research Institutes Act 1992 (CRI Act) to:
- undertake research for the benefit of New Zealand;
 - comply with any applicable ethical standards;
 - promote and facilitate application of the results of research and technological developments;
 - be a good employer and exhibit a sense of social responsibility; and
 - operate in a financially responsible manner so that they maintain their financial viability.

[paragraph 14]

- 18 Where an entity’s founding documents provide that an entity has multiple objectives, determining the primary objective will depend on an assessment of the substance of the purpose of the entity. [based on paragraph 15]
- 19 In assessing the substance of the purpose of the entity where there are multiple objectives, it may be helpful to consider how the entity assesses its performance, as this may indicate which of its stated objectives is its primary objective. For example, if the entity has performance targets for a rate of return on assets or a percentage of return to equity holders, this may indicate the entity is a for-profit entity. However, if the performance targets focus on the level/amount of benefits that have been delivered to achieve a community or social outcome, this may indicate that the entity is a PBE. [new]
- 20 The founding documents may require an entity to be financially viable or to generate an adequate rate of return. However, being financially viable is not in itself conclusive in distinguishing a for-profit entity from a PBE. There is often a community expectation that PBEs will be financially viable and operate to ensure that the limited resources at their disposal are used effectively. [based on paragraph 16]

Nature of the benefits, including the quantum of expected financial benefits

[new merged indicator]

- 21 The nature of the benefits provided by an entity including the quantum of the expected financial benefits, may indicate whether an entity is a PBE. [based on paragraph 17]
- 22 Unlike for-profit entities, PBEs do not exist to generate a financial surplus in order to provide a financial benefit/return to equity holders. Instead, they exist to provide goods or services for community or social benefit. Hence, if an entity provides goods or services to recipients at no cost or for nominal consideration, the entity is likely to be a PBE. This does not imply that PBEs never generate, or aim to generate, a financial surplus on the net assets employed. However, where a PBE does generate a financial surplus, it may be required or expected to be used to support the entity’s primary objective of providing goods or services for community or social benefit, rather than for providing a financial benefit to equity holders. [based on paragraph 18]

² Section 4 State-Owned Enterprises Act 1986

³ Section 5(1) Charities Act 2005

- 23 PBEs may establish controlled entities or discrete business units which operate to generate a financial surplus that can be used to support the primary activities of the controlling entity. Such entities or business units may be for-profit. This fact does not affect the classification of the controlling entity or group.⁴ [based on paragraph 19]
- 24 The benefits provided by for-profit entities are financial in nature. Most for-profit entities aim to generate a commercial or market return – that is, to maximise the financial benefit/return to equity holders commensurate with the relative risks of operating. Hence, the quantum of the expected financial benefits may indicate whether an entity is a for profit entity or a PBE. [based on paragraph 21]
- 25 When considering the quantum of the expected financial benefits and the nature of the benefits provided by an entity, it is important to recognise that the generation of profits and payment of dividends is only one form of financial benefit that can be provided to equity holders. There are many other forms of financial benefit that can be returned to members or equity holders. For example, cooperatives provide a financial benefit to members by paying a rebate based on the volume of transactions with the entity rather than through the payment of dividends. Another example of a financial benefit is the provision of discounted goods and services by an entity to its members. [new]

Primary beneficiaries of the benefits

- 26 An understanding of who the primary beneficiaries of the benefits provided by the entity are (i.e. the people who primarily benefit from the activities of the entity) will assist in determining whether an entity is a PBE. [new]
- 27 Typically, the primary beneficiaries of a for-profit entity are its equity holders (including its parent, where the reporting entity is controlled by another entity)⁵ or other providers of economic resources to the entity (such as debt holders or suppliers). These parties provide economic resources to the entity in exchange for an entitlement to financial returns. [new]
- 28 In contrast, as the primary objective of a PBE is to provide goods or services for community or social benefit, typically the primary beneficiaries of PBEs are members of the community (or a particular section of the community), rather than resource providers. [new]
- 29 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 PBE. For example, a heritage trust where membership monies are used for maintaining and enhancing heritage assets for the benefit of the wider community. However, if the primary beneficiaries are members of the entity, it is necessary to consider other factors to determine whether the entity is a PBE (for example, the nature of the benefits and other indicators discussed in this Appendix). [new]

Nature of equity interest

- 30 Where an entity is established to generate a financial return for the benefit of the equity holders the ownership instrument is usually clearly defined. This is important for for-profit entities because it determines the level of financial benefits/returns such as dividends and rights to the residual net assets. If an entity does not have any clear equity holders or the nature of the equity instrument is unclear, the entity is likely to be a PBE. [based on paragraph 24]
- 31 The absence of clear equity holders may manifest itself in a number of ways, including:
- the absence of an individual or entity having a right to participate in any financial return or in the net assets of the entity were it to be wound up or otherwise cease to operate; or
 - a requirement that in the event the entity ceases operating any residual net assets are to be applied to another entity with a similar purpose or to revert to another PBE. That is, the use of the assets is effectively restricted to providing goods or services for community or social benefit.

[based on paragraph 25]

⁴ If a controlled entity or business unit is required to prepare general purpose financial reports its classification is determined by its own primary objective and not that of the controlling entity of the group.

⁵ As noted in paragraph 12, the assessment of the classification of an entity as a PBE or for-profit entity is made at the reporting entity level. Where the reporting entity is controlled by a PBE, how the PBE parent uses the financial returns provided by the reporting entity to its parent is not relevant to the assessment of whether the reporting entity should be classified as a for-profit entity or PBE.

Purpose and use of assets

- 32 The reasons an entity acquires and/or holds an asset may indicate whether it is a PBE. For-profit entities hold assets mainly for sale or for generating a financial benefit for equity holders. The primary reason PBEs (particularly public sector PBEs) hold property, plant and equipment and other assets (including infrastructure assets) is usually for their potential to provide future services for community or social benefit rather than their ability to generate a financial benefit for equity holders. If an entity holds assets primarily for delivering future services for community or social benefit, the entity is likely to be a PBE. [new]
- 33 For example, PBEs may hold assets that contribute to the historical and cultural character of a nation or region, such as art treasures, historical buildings and other artefacts. Other PBEs may be responsible for national parks and other areas of natural significance with native flora and fauna. Such historical items and land are generally not held for sale, even if a market exists. Rather, the respective PBEs have a responsibility to preserve and maintain them for current and future generations. [new]

Nature of funding

- 34 If an entity relies wholly or primarily on donations or other contributions whereby the resource provider does not receive an entitlement to financial returns (or other economic resources) from the entity in return, the entity is likely to be a PBE. [based on paragraph 26]
- 35 Many PBEs are dependent on grants and donations. In addition, the sources of funding are usually from third parties (i.e. a source other than the beneficiaries of their services). For example, public sector PBEs receive appropriations and other public funds to carry out their services. Not-for-profit PBEs may rely on government grants, donations from philanthropic organisations and donations and bequests from the public. There may also be restrictions imposed by the provider of the funding on how the funds may be spent. [new]
- 36 PBEs also receive funding through the provision of donated services. For example, many not-for-profit entities rely heavily on volunteers (rather than paid employees) to deliver their services to the community. [new]
- 37 In contrast, for-profit entities are funded primarily by equity holders, debt holders and other suppliers of economic resources, in exchange for an entitlement to dividends, interest and other forms of financial returns (or other economic resources). [new]

Conflicting indicators

- 38 When considering the classification of an entity, in some cases the above indicators may conflict with each other and the primary objective or purpose of the entity may not be obvious. Some indicators may indicate that an entity should be classified as a for-profit entity and others may indicate the entity should be classified as a PBE. In this situation professional judgement is required to evaluate the indicators overall and in combination with each other, including the significance of particular indicators to the overall assessment, to determine whether, in substance, the entity meets the definition of a PBE. For example, if the entity has only a small amount of equity, considering the nature of its equity interest may be less helpful than the other indicators when determining whether, in substance, the entity meets the definition of a PBE. [based on paragraph 27]

Changing classification

- 39 Although not expected to be common, changing circumstances may lead to a change in an entity's classification from a PBE to a for-profit entity and vice versa. For example, the constitution of an entity may be amended to change an entity's primary objective from one that is for-profit focused to one that is public benefit focused. [based on paragraph 28]
- 40 Accounting for a change in classification depends on the applicable accounting requirements of the new classification. An entity will need to first determine its applicable tier of financial reporting, in accordance with XRB A1. XRB A1 paragraphs 14–30 set out the Tier structure for for-profit entities, and paragraphs 31–72 set out the Tier structure for PBEs. The entity would then need to apply the applicable accounting requirements for its tier of financial reporting, including the requirements on the first-time adoption of that tier of reporting. For example, if an entity's classification changes from a PBE to a for-profit entity, the entity would need to apply NZ IFRS 1 *First-time Adoption of New Zealand Equivalents to International Financial Reporting Standards*. [based on paragraph 29]

ILLUSTRATIVE EXAMPLES: Determining whether or not an entity is a PBE

- 41 The following examples aim to illustrate application of this Appendix. The examples are illustrative only and do not establish requirements. [paragraph 30]
- 42 While specific types of entity are referred to in the examples, the circumstances in relation to individual entities may vary significantly, and therefore the examples do not conclude as to whether the entity in question is or is not a PBE. Rather, the examples illustrate indicators to be considered by preparers in reaching a conclusion regarding whether or not an entity is a PBE. In assessing this classification an appropriate weighting needs to be given to each individual indicator. Depending on the circumstances some indicators will provide a stronger indication than others about whether or not an entity should be classified as a PBE. The entity will need to consider each indicator against the other indicators and make an overall assessment of whether or not the entity is a PBE. [based on paragraph 31]

Example 1: Crown Research Institute (CRI)

Entity A is a company established under section 11 of the Crown Research Institutes Act 1992 (the CRI Act).

Stated objectives

The CRI Act states that the purpose of every CRI is to undertake research (section 4) and sets out the principles of operation CRIs are expected to follow in fulfilling this purpose. These principles are set out in section 5 of the Act and include, for example, that a CRI should undertake research for the benefit of New Zealand, operate in a financially responsible manner and be a good employer.

The CRI Act establishes a broad framework for the operation of CRIs. The primary objective (purpose) of CRIs is clearly stated in the CRI Act. The principles set out in section 5 are detailed, but they are not ranked and their implementation can be achieved in a number of ways. CRIs, therefore, appear to have discretion as to how they can achieve their purpose.

Nature of the benefits, including the quantum of expected financial benefits

The key benefit of establishing CRIs is the production of research that will benefit New Zealand. In one sense the CRIs undertake research for community or social benefit. The New Zealand economy and entities operating in New Zealand can benefit from the research undertaken.

However, there may be discretion as to how research findings are distributed, in determining the nature of the research to be undertaken and whether the entity intends to generate a financial return for its equity holder (i.e. the Shareholding Minister).

If Entity A distributes the research findings to its customers on a fee-for-service basis with the aim of generating a financial surplus for its equity holder equivalent to a market return, this may indicate that Entity A is a for-profit entity.

If however Entity A undertakes research of a nature that will benefit New Zealand more broadly and makes its research findings available free of charge or for a nominal charge then the benefits provided would be community/social in nature, which may indicate that Entity A is a PBE.

Primary beneficiaries of the benefits

Although Entity A is a company, the primary beneficiaries of the benefits may not necessarily be the Shareholding Minister or the Government.

If the CRI sells its research on a commercial basis for the purpose of providing a financial return to the Shareholding Minister (i.e. the equity holder) then the primary beneficiary would be the entity's equity holder, which may indicate that Entity A is a for-profit entity.

Whereas if the research findings are made available for a nominal fee or free of charge for the benefit of the wider community, such as all entities operating in New Zealand with an interest in those research findings, then the primary beneficiaries would be the wider community, which may indicate that Entity A is a PBE.

Nature of equity interest

Entity A is a company. The equity interest is in the form of shares owned by the Shareholding Minister. In the case of Entity A, the nature of the equity interest is clear. In addition, there is no restriction on the use of assets in the event Entity A is sold, wound up or ceases to operate. This may indicate that Entity A is a for-profit entity.

Conversely, if the company constitution provides that in the event Entity A is wound up, or otherwise ceases to operate, its net assets are required to be transferred to another entity with a similar purpose, this may indicate that Entity A is PBE.

Purpose and use of assets

Entity A owns property, plant and equipment that it uses to undertake research and produce research reports. If Entity A holds those assets to sell or to generate a commercial financial return for the Shareholding Minister, this may indicate that Entity A is a for-profit entity.

However, if the property, plant and equipment is used to undertake research and report on the research findings for the benefit of the New Zealand public then the assets would be held for their potential to provide services to the community, which may indicate that Entity A is a PBE.

Nature of funding

Entity A competes for funding from government and private sources.

If the CRI funds its research activities primarily through charging commercial fees to customers for research services, this may indicate that Entity A is a for-profit entity.

Conversely, if, funding is derived primarily through government grants and donations from private organisations, and there is no requirement to deliver research findings to those funding organisations in return, this may indicate that Entity A is a PBE.

Example 2: Bicycle Shop

A charitable trust is established with the objective of providing health services to the homeless. The Trust receives an annual grant from the Government. The grant is sufficient to cover operating costs necessary to provide basic health care services to a limited number of people. To meet the increasing demand for its services and to fund an expanded range of services, the Trust establishes a bicycle shop (Company 1).

Company 1 sells second hand bicycles and runs a successful bicycle hire service. All surpluses from Company 1 are returned to the Trust to support the primary objective of providing health services to the homeless.

Stated objectives

Company 1's constitution specifies that its objective is to raise funds to support the charitable trust. Therefore, as the entity's stated objective is to generate financial returns for its equity holder, this may indicate that the entity is a for-profit entity.

Conversely, if the entity's stated objective was to provide some form of community or social benefit (e.g. to provide employment for the homeless), this may indicate that the entity is a PBE.

Nature of the benefits, including the quantum of expected financial benefits

Company 1 returns financial surpluses generated through the sale and hire of bicycles to the Trust.

If bicycles are sold and hired at market rates with a view to maximising the financial surplus returned to the Trust, then the nature of the benefits would be financial, which may indicate that the bicycle shop is a for-profit entity.

However, if the shop is used primarily to provide employment to the homeless, and/or the bikes are sold at below market rates or hired out at a nominal/low rate to enable the disadvantaged to benefit from exercise (with any incidental financial surplus returned to the Trust), then the entity would be providing community or social benefits, which may indicate that Company 1 is a PBE.

Primary beneficiaries of the benefits

If bicycles are sold and hired at market rates and the primary beneficiary of the financial surpluses derived is the Trust (i.e. the equity holder), then this may indicate that Company 1 is a for-profit entity.

However, if any financial surplus derived by Company 1 is incidental to employing the homeless and/or providing affordable access to bicycles for the disadvantaged, then this may indicate that Company 1 is a PBE. In this case, the primary beneficiaries of the benefits (employment and bicycle affordability) provided by Company 1 are the homeless and the disadvantaged.

Nature of equity interest

Company 1 is 100% owned and controlled by the Trust. As such the ownership arrangement and equity holder is clear.

If in the event Company 1 ceases trading the trustees are able to determine how to use any residual assets of Company 1, then this may indicate that Company 1 is a for-profit entity.

However, if the trust deed provides that in the event Company 1 ceases trading any residual assets must be donated to a charity that fulfils the same or a very similar charitable purpose to that of the Trust, then this may indicate that Company 1 is a PBE.

Purpose and use of assets

If the directors of Company 1 aim to ensure that the return on the net assets invested in the shop is at least equivalent to a market return, they may recommend that the Trust invest its funds in another activity if a market return is not achieved. This may indicate that Company 1 is a for-profit entity.

However, if Company 1 was operated with the objective of generating a sufficient return on the net assets for it to continue to be a viable organisation, with no reference to a market return on the net assets invested, and instead its assets were used to provide goods or services for community or social benefit (i.e. enabling the disadvantaged to benefit from exercise) this may indicate that Company 1 is a PBE.

Nature of funding

Company 1 funds its activities through the sale and hire of bicycles. The Trust provided a small capital contribution to ensure the shop could purchase bicycles in addition to any that were donated. Company 1 pays a small rental to the Trust. Other outgoings are minimal and there are no borrowings.

If a significant number of the bicycles for hire and for sale were donated by members of the community, this may indicate that Company 1 is a PBE. Similarly, if most of the employees of Company 1 are volunteers, this may indicate that Company 1 is a PBE.

If, however, the funding is derived primarily from the sale and hire of bicycles at normal commercial rates and the Trust expects a return on its investment, this may indicate that Company 1 is a for-profit entity.

Example 3: Private Education Organisation

Entity B is a private organisation dedicated to providing low-cost high-quality education to children who immigrated to New Zealand from poverty-stricken countries. Entity B was established as a Trust with an initial endowment of \$5m from the estate of a wealthy business person.

In order to supplement its income Entity B accepts a limited number of fee-paying students. The fees for such students were determined after market research into the pricing of such services. All fee revenue is applied by Entity B to its objective of providing high-quality education to children who immigrated to New Zealand from poverty-stricken countries. The revenue from fee-paying students has enabled Entity B to expand the range of services it offers and to expand its roll of immigrant children.

The trustees carefully manage the resources of Entity B in order to maximise the number of immigrant children it can accept and to maintain a high-quality educational service. The trustees have a clear operational plan and have established clear financial targets in order to achieve the trust's objectives.

Stated objectives

The trust deed establishing Entity B states that the purpose of Entity B is to provide high-quality education to children who immigrated to New Zealand from poverty-stricken countries.

As Entity B's objective is to provide high-quality education to immigrant children from poverty-stricken countries (i.e. to provide a community or social benefit), this may indicate that Entity B is a PBE.

If the trust deed states that Entity B's purpose is to maximise its financial surplus from fee-paying students while also providing high-quality education to immigrant children, this may indicate that Entity B is a for-profit entity.

Nature of the benefits, including the quantum of expected financial benefits

The nature of the benefits provided by Entity B are the educational services delivered to children from poverty-stricken countries. The equity has been provided to Entity B for the benefit of immigrant children and not for the generation of a financial return for equity holders. The nature of the benefits provided is primarily community/social, which may indicate that Entity B is a PBE.

If the financial targets established by the trustees are expressed in terms of meeting the development targets set out in the operational plan rather than being expressed in terms of a return on equity, this may indicate that Entity B is a PBE.

However, if the financial targets are expressed in terms of a return on equity, this may indicate that Entity B is a for-profit entity.

If Entity B established a subsidiary entity through which it ran its commercial education operations to maximise profits to be paid back to the Trust, then that subsidiary may be a for-profit entity. In this case it would also be necessary to consider whether the group reporting entity is a PBE by considering the characteristics of the controlling entity of the group.

Primary beneficiaries of the benefits

If the objective of Entity B is to provide high-quality education to immigrant children, with any surplus generated used to expand the number of immigrant children who are provided with high-quality education, the primary beneficiaries are the immigrant children. This may indicate that Entity B is a PBE.

If the trust deed identifies specific parties as beneficiaries of the trust (i.e. not the immigrant children) and Entity B limits the amount of surplus used to expand the education programme to immigrant children in order to generate a financial return for the specified beneficiaries, this may indicate that Entity B is a for-profit entity.

Nature of equity interest

Entity B is a trust, so there are no clearly defined ownership instruments.

The trust deed requires that in the event Entity B ceases operating any residual assets are to be distributed to another entity with a similar purpose. The use of the assets is restricted, and there are no clear equity holders that have an entitlement to those assets. This may indicate that Entity B is a PBE.

If the trust deed provides that in the event Entity B ceases operating any residual assets are to be distributed to other specified parties (e.g. the specified beneficiaries), this may indicate that Entity B is a for-profit entity.

Purpose and use of assets

Entity B provides education to both immigrant children and to fee-paying students. The trustees have a clear operational plan and have established clear financial targets to achieve the trust's objectives.

If Entity B uses its assets to provide high-quality education to immigrant children from poverty-stricken countries, rather than to generate a financial return on its equity then this may indicate that Entity B is a PBE.

If the trustees of Entity B require a commercial financial return on those assets, this may indicate that Entity B is a for-profit entity.

Nature of funding

Entity B receives funding from several sources: investment income from the initial endowment, income from fee-paying students, and donations from the public and fundraising activities.

If this funding is derived predominantly from third parties who do not benefit from Entity B's services, and the resource provider does not receive an entitlement to financial returns (or other economic resources), this may indicate that Entity B is a PBE.

If Entity B derives its funding predominantly from fee-paying students and other resource providers in exchange for an entitlement to financial returns (or other economic resources) from the entity, this may indicate that Entity B is a for-profit entity.

Example 4: Sports Club

Club AFC is a football club established in a suburb of a large city. Club AFC organises competitions and provides coaching and training for a wide range of age groups, from five-year-olds through to senior grade, and representative grades.

Stated objectives

Club AFC is established as a charitable trust. Its constitution states that it is a non-profit entity established to foster participation and to promote amateur football in its suburb. This indicates that Club AFC may be a PBE.

If, however, the constitution stated that Club AFC's objective is to maximise profits for the club, then this may indicate that Club AFC is a for-profit entity.

Nature of the benefits, including the quantum of expected financial benefits

The benefits provided by Club AFC arise from the coordination of football competitions and the provision of football coaching and training to club members. This may indicate that Club AFC is a PBE.

If Club AFC were to sell a significant amount of its coaching, and training services (e.g. to schools, other football clubs, or individuals) at normal market rates, with the aim of generating financial returns for its members this may indicate that Club AFC is a for-profit entity.

If Club AFC uses the surpluses from selling its services to ensure the Club remains financially viable with any surplus used to develop the services it offers to club members and the wider amateur football community, this may indicate that Club AFC is a PBE.

If the financial targets are set with the objective of generating a commercial rate of return for its members, this may indicate that Club AFC is a for-profit entity.

Primary beneficiaries of the benefits

Club AFC provides training and coaching for all age groups and grades of players who are members of the club. The Club also organises football competitions in which other amateur football clubs participate.

If the Club's activities primarily benefit the wider community (for example, by promoting soccer as part of a keeping active programme, providing some coaching at no cost for schools or providing free soccer memberships for disadvantaged children in the community), this may indicate that Club AFC is a PBE.

If, however, the primary beneficiaries of the Club's activities are the members of Club AFC, it is necessary to consider other factors (for example, the nature of the benefits and other indicators discussed in this Appendix) to determine whether the entity is a PBE.

Nature of equity interest

Club AFC is a member-based entity and there are no clear equity holders. This may indicate that the Club is a PBE. If, however, the Club was owned by shareholders expecting a financial return on their investment in the Club, this may indicate that the Club is a for-profit entity.

If the constitution states that in the event the Club is wound up or ceases operating, any residual assets are to be applied to an organisation with a similar purpose as Club AFC, this may indicate that the Club is a PBE.

However, if the constitution states that in the event the Club is wound up or ceases to operate any residual assets are to be distributed to the members, this may indicate that the Club is a for-profit entity.

Purpose and use of assets

Club AFC's assets comprise primarily football equipment (nets, balls, uniforms etc), as well as tripods and filming technology used to analyse matches for the purpose of coaching and training. A small shed is leased at the local community centre to store the equipment.

If the Club's assets are used primarily to provide coaching, training and competitions for amateur players in the community, then this may indicate that Club AFC is a PBE.

However, if Club AFC sells a significant amount of its coaching and training services and charges commercial market rates to other individuals or entities for using its tripods and filming technology, then its assets may be generating a financial return for its members. This may indicate that the Club is a for-profit entity.

Nature of funding

Club AFC receives funding from membership fees, donations, sponsorship and community grants.

If this funding does not establish a financial interest in the Club, this may indicate that Club AFC is a PBE.

If Club AFC receives funding primarily from members and other resource providers who are expecting either a financial return on their investment or other economic resources in return for providing funds, this may indicate that Club AFC is a for-profit entity.

Example 5: Social Enterprise

The social enterprise model is becoming a more prevalent way for entities to operate. It is important to note that an entity that identifies itself as a social enterprise may not necessarily be a PBE. It is possible for an entity that identifies itself as a social enterprise to be a for-profit entity that also has a social objective.

Entity C is a company which donates one lunch for a hungry school child at a low decile school for every lunch that it sells to the public, that is, the cost of the donated lunch is built into the cost of the lunch that is sold.

Stated objectives

Entity C's constitution states that its objective is to provide healthy food, including lunches, to patrons and to children at low decile schools.

If Entity C's constitution states that its objective is to help children at low decile schools by providing healthy lunches, this may indicate that Entity C is a PBE.

If Entity C's objective is to maximise profits while also achieving a social objective of providing healthy lunches to children at low decile schools, this may indicate that Entity C is a for-profit entity.

Nature of the benefits, including the quantum of expected financial benefits

If Entity C generates substantial surpluses, after covering the costs of free lunches, with those surpluses distributed to its shareholders or retained for additional business investments, the nature of the benefits provided are primarily financial. This may indicate that Entity C is a for-profit entity.

If Entity C uses the surpluses from the sale of lunches primarily to fund the costs of the free lunches and other operating costs, with any surplus used to expand the number of free lunches provided to school children, the nature of the benefits provided are primarily community/social. This may indicate that Entity C is a PBE.

Primary beneficiaries of the benefits

Entity C has three shareholders.

If Entity C limits the amount of its surplus from the sale of lunches that can be used to provide free lunches, to ensure that it generates an adequate financial return for its shareholders, the primary beneficiaries are the shareholders, which may indicate that Entity C is a for-profit entity.

Conversely, if Entity C uses most of the surpluses from the sale of lunches to provide free lunches to children in low decile schools rather than distributing the profits to its shareholders, the primary beneficiaries are the children at low decile schools. This may indicate that Entity C is a PBE.

Nature of the equity interest

Entity C has two founding shareholders. To enable expansion plans to be completed, additional shares were issued to a shareholder who has a prominent business in the food distribution sector. The equity holders are clearly identifiable by the equity instruments they hold.

If:

- (a) there were no entitlements to dividends;
- (b) all profits were reinvested in Entity C; and
- (c) on Entity C ceasing to operate, any residual assets were to be donated to an entity with a similar charitable objective,

this may indicate that Entity C is a PBE.

If Entity C's shareholders have an entitlement to dividends and to a share of the residual net assets of the entity if it is wound up, this may indicate that Entity C is a for-profit entity.

Purpose and use of assets

Entity C acquires or holds its assets to provide healthy lunches for children in low decile schools and to make lunches and healthy food that are sold to the public.

If the assets are used primarily to provide healthy lunches for children in low decile schools, this may indicate that Entity C is a PBE.

If Entity C acquires or holds its assets primarily to sell or to generate financial benefits for its equity holders, this may indicate that Entity C is a for-profit entity.

Nature of Funding

Entity C's equity was initially provided by shareholders.

If Entity C relies primarily on donations and grants from the general public and funding organisations, and has a predominantly volunteer workforce, this may indicate that Entity C is a PBE.

If Entity C's funding is provided primarily by shareholders and other resource providers in exchange for an entitlement to financial returns (e.g. dividends) or other economic resources, this may indicate that Entity C is a for-profit entity.

Part D: Effective date

This [draft] Standard is effective for periods beginning on or after [Date – proposed date is 1 January 2020], with earlier application permitted.