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24 April 2026

Dr Keith Kendall FCPA
Chair
Australian Accounting Standards Board
PO Box 204, Collins Street West, Victoria 8007

Via online submission: www.aasb.gov.au

Dear Kieth

Supplementary comments on application of the AASB 18 income statement categorisation requirements by not-for-profit (NFP) private sector entities and universities, including in relation to income recognised under AASB 1058

As one of the largest professional accounting bodies in the world, CPA Australia represents the diverse interests of more than 175,000 members working in over 100 jurisdictions and regions around the world, working in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally. We provide the following feedback on the additional consultation on the application of the AASB 18 income statement categorisation requirements by not-for-profit (NFP) private sector entities and universities, including in relation to income recognised under AASB 1058. We restrict our feedback to NFP entities as we have not had the opportunity to gain sufficient feedback from universities on this consultation.

Overall, as noted in our submission in response to Exposure Draft - *Application of AASB 18 and AASB 107 by Superannuation and Not-for-Profit Entities and Operating Cash Flow Reconciliation for entities preparing Tier 1 general purpose financial statements* (ED 338), we received mixed views from stakeholders, but on balance agreed we agree that the core classification framework under AASB 18 should apply to Tier 1 and 2 NFP entities. In our view, the operating, investing and financing categories should continue to apply to these entities, although we acknowledge that some aspects of the framework may be less intuitive in an NFP context and would benefit from further implementation support. We also note the recommendation that a post-implementation review should explicitly assess the cost-benefit balance and comparability impacts of applying AASB 18 to NFP private sector entities and for-profit public sector entities, including consolidation effects.

Our key recommendations are as follows:

- Income recognised under AASB 1058 should generally be classified based on its nature at the point of receipt or recognition, rather than by reference to how the related funds or assets may later be used. Concerns about volatility or uneven outcomes are better addressed through clearer disaggregation, labelling and explanatory disclosure than through reclassification.
- The concept of specified main business activities should remain unchanged for NFP entities where the facts and circumstances support its application. Rather than removing the concept or introducing broad accounting

policy choices, the AASB should consider providing sector-specific illustrative examples and practical guidance where necessary to support more consistent application in an NFP context.

Further detail on our above comments, including our responses are included in the Attachment. If you require further information, please contact me at ram.subramanian@cpaaustralia.com.au.

Yours sincerely

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Financial Reporting Lead
CPA Australia

ATTACHMENT – CPA AUSTRALIA'S RESPONSES

Topic 3: What are examples of common types of income and expenses that would be categorised in each of the operating, investing and financing categories (for activities outside the specified main business activities)?

Q1: Do you have significant concerns about requiring an NFP entity to categorise the items described in AASB 18.53, 54, B47 and B48 in the investing category (e.g. interest income from cash and cash equivalents)? Please provide reasons.

Q2: Do you have significant concerns about requiring an NFP entity to categorise the items described in AASB 18.59, 60, 61, B53 in the financing category? Please provide reasons.

Q3: Do you have significant concerns about requiring an NFP entity to classify interest income and expenses relating to liabilities (e.g. lease interest) as financing, while related non-interest items (e.g. depreciation of ROU asset) are classified as operating?

As noted in our submission in response to ED 338, we received mixed feedback from members on the application of the core classification model in AASB 18 *Presentation and Disclosure in Financial Statements* (the "Standard"). On balance, however, we do not object to applying the Standard's operating, investing and financing categories to these entities, recognising the potential transparency benefits while also noting the importance of clear implementation guidance and illustrative examples.

We note that users of NFP financial statements often assess performance differently from users in the for-profit context. They may focus more on principal activities, stewardship and the sustainability of funding, rather than the narrower notion of "operating activities" under the Standard. As a result, strict application of the framework may sometimes produce outcomes that are technically consistent with the Standard but not immediately intuitive to users of NFP financial statements.

However, based on feedback we have received, this does not justify changing the classification model itself at present. Rather, it highlights the importance of clear disaggregation, appropriate line-item labelling and explanatory disclosures so that users can better understand the nature of significant income and expense items, particularly where results may appear volatile or uneven between periods. Consistent with this, we support the view that financial reporting should reflect the underlying economics of transactions, rather than 'smoothing' or obscuring those effects through reclassification.

We also note that some views raised in the discussion appear to reflect a preference to distinguish income based on restrictions, designated purposes or intended use of funds. While we understand why those distinctions may be useful from the perspective of external users who want to see restricted funds being used for the intended purpose, and from an internal management, governance or stewardship perspective, we do not think they should determine classification outcomes under AASB 18. In our view, classification should continue to follow the principles in the Standard, rather than be driven by whether funding is restricted, unrestricted or earmarked for a particular purpose. Appropriate disaggregation of line items to illustrate the nature of restricted or designated funds, complemented with additional note disclosures, may assist with any additional user information needs on this matter.

Accordingly, our preliminary view is that NFP entities (and universities) should continue to apply the general framework in the Standard. To support implementation, the AASB could usefully provide illustrative examples and practical guidance (including disaggregation presentation an disclosures) showing how the framework applies to common NFP fact patterns.

Topic 4: How would income recognised under AASB 1058 be categorised?

Q4: Given AASB 18 allows distinguishing between recurrent and non-recurrent items within a category, is there a need for the AASB to modify AASB 18 or provide further guidance? Please explain.

Q5: Have you identified any NFP-specific circumstances that would justify departing from AASB 18 classification requirements (e.g. classifying items differently between operating and investing)? If so, describe and explain why.

Based on the discussion and feedback received, we understand the concern that including income recognised under AASB 1058, particularly bequests, donations, donated non-cash assets and capital grants, within operating may, in some cases, make the operating result appear volatile or less reflective of what some users regard as the entity's underlying or principal activities.

However, in our view, this does not justify reclassifying such income outside the operating activities category. We consider that the nature of the income should be determined at the point it is received or recognised, rather than by reference to how the related funds or assets may later be used. On that basis, bequests, donations and grants received by NFP entities should generally be classified as operating income (assuming they do not meet the definitions relevant for classification under the investing or financing category), as they arise from the entity's mission-driven activities, fundraising activities or broader funding model. Where those funds are subsequently invested, or the related assets generate investment returns, those later outcomes should be classified separately in accordance with the relevant principles in the Standard.

We recognise that some stakeholders may view this outcome as creating volatility or "lumpiness" in reported operating results, particularly where receipts are large or non-recurring. Nevertheless, we do not regard that as a reason to alter the underlying classification. Rather, such outcomes reflect the economic reality of many NFP entities, and financial reporting should faithfully represent that reality rather than smoothing or obscuring it through reclassification.

Instead, we consider that the more appropriate response is clear disaggregation and explanation. Where income recognised under AASB 1058 is significant, unusual or non-recurring, entities should be able to present and explain those amounts in a way that helps users understand their nature and effect. In our view, this would better support transparency and comparability than introducing alternative classification outcomes or accounting policy choices.

We also do not support introducing an accounting policy choice in this area. Allowing similar receipts to be classified differently across entities would risk reducing comparability and could undermine the consistency that the Standard is intended to promote. If further support is needed, we believe it would be more helpful for the AASB to provide additional illustrative examples or explanatory guidance, including clarification, where necessary, on how the relevant paragraphs in AASB 18 apply to income recognised under AASB 1058.

Topic 6: How are income and expenses relating to specified main business activities classified?

Q6: Do you agree that NFP entities should be required to assess whether they invest in assets or provide finance to customers as a main business activity for classification purposes? Please explain.

Q7: If yes, is additional guidance (beyond AASB 18.B34–B35) needed to assist NFP entities in making this assessment? If so, what guidance and why?

Q8: Overall, do you agree that NFP entities should be required to classify income and expenses into operating, investing and financing categories, and that the benefits outweigh the costs? Please explain.

We do not consider that NFP entities should be excluded from assessing whether investing in assets or providing finance to customers constitutes a specified main business activity.

In our view, the concept remains relevant in the NFP sector where the facts and circumstances support its application. Some NFP entities may, in substance, have investing or financing as a significant, or even dominant, activity, notwithstanding that those activities are undertaken to support charitable, educational or religious purposes rather than commercial profit-making. Examples include ancillary funds managing large investment balances with mandatory distributions, religious development funds and church-related lending vehicles, some credit unions, microfinance charities and other hybrid mission-driven entities, as well as universities or schools with significant endowment or investment structures. These examples suggest that such cases may be more common, and more complex, than implied by the assumption that they would arise only infrequently or be relatively straightforward to identify.

We acknowledge that, in the NFP context, investing or financing activities may often be undertaken in support of broader service delivery objectives. This can make it more difficult in practice to determine whether such activities constitute a specified main business activity in their own right. Stakeholders also raised concerns that similar entities may reach different conclusions in making that assessment, which could reduce comparability, particularly among universities and other entities with similar structures. In addition, where investment income is classified separately from the related charitable or educational expenditure it supports, this may create a mismatch that could confuse users and obscure the overall picture of performance. However, while we recognise these practical challenges, we do not consider that they justify removing the concept altogether or introducing broad accounting policy choices, as either approach would risk undermining consistency and comparability across the sector.

Accordingly, our view is that NFP entities should continue to classify income and expenses into operating, investing and financing categories, including assessing specified main business activities where relevant. The more appropriate response would be for the AASB to consider providing clearer implementation support, particularly through additional illustrative examples and practical guidance tailored to common NFP fact patterns. This would better assist entities in applying the requirements consistently in practice, while preserving the integrity of the overall classification model.

Topic 7: What are the changes to the dividend and interest cash flow classification?

Q9: Do you have significant concerns about requiring dividends and interest paid to be classified as financing cash flows, and dividends and interest received as investing cash flows? If so, what alternative classification would be more appropriate and why?

Q10: Do you have any comments on applying other aspects of AASB 18 to NFP entities (e.g. operating expense presentation, MPM disclosures, aggregation/disaggregation)?

Q11: Have you submitted a comment letter on ED 338 or ITC 56?

In our view, the classification of dividends and interest cash flows should continue to follow the principles set out in the Standard. Although such cash flows may be important in funding an entity's broader activities, that does not necessarily mean they should be classified according to their eventual use. As with other areas of the Standard, classification should be determined by principle, rather than by management intention or by how funds are ultimately applied.

Accordingly, we do not presently see a strong basis for special amendments for NFP entities and universities in relation to Topic 7. If the AASB considers that further support would be helpful, illustrative examples showing how the requirements apply in common NFP circumstances may assist implementation. However, on the information presently available, we do not think substantive changes to the existing classification approach are warranted.