

# The perceptions of NFP managers: Initial insights on financial statement preparation, the conceptual framework, and accounting standards

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# Presentation overview

- Introduction
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- Which NFP organisations should prepare financial statements compliant with accounting standards?
- Conceptual framework issues
  - Common conceptual framework
  - Objective of financial reporting
  - Accounting standards – sector neutral approach
- Usefulness of financial information
  - Internal users
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- Why do NFP organisations maintain an accounting system?
- Conclusions

- Summary of findings from report prepared for AASB and a working paper:
  - Kober, R. Lee, J. Ng. (2016). “Report prepared for the AASB on the perceptions of not-for-profit managers: Initial insights on financial statement preparation, the conceptual framework, and accounting standards”.
  - Kober, R. Lee, J. Ng. (2016). “A different point of view: The perceptions of Australian not-for profit managers and financial statement preparers on a common conceptual framework, sector neutrality and the usefulness of financial information”

- Explore the perceptions of NFP managers and financial statement preparers on:
  - Who should be required to prepare an annual financial statement
  - Issues associated with a common conceptual framework
  - Application of accounting standards – sector neutral approach
  - The usefulness of financial information (for internal and external stakeholders)
  
- Importance of NFP organisations
  - Australia
    - in excess of 600,000 NFP organisations (Productivity Commission, 2010)
    - Total income in excess of \$103 billion (Cortis et al., 2015)
    - Employing more than 1 million people (Cortis et al., 2015)
  - England
    - 165,334 charities on official register (Charities Commission, 2016)
    - Revenue in excess of £70 billion (Charities Commission, 2016)

- Divergence of practice
  - Australia sector (transaction) neutral approach
  - Canada, UK, US, and now NZ separate standards for NFP sector
- Given Australia's unique position we have an opportunity to explore the perceptions of NFP managers and financial statement preparers who are familiar with a sector neutral approach
- Surveyed 1,000 NFP organisations with revenues in excess of \$1 million
  - Randomly selected from ACNC database
  - Two questionnaires sent to each NFP organisation
    - One to the general manager/CEO
    - One to the CFO/Chief accountant/financial statement preparer
  - Received 242 useable responses

# Sample profile

	<b>Managers</b>	<b>CFO / Senior Accountants</b>	<b>Total</b>
Usable responses	113	123	242
Member of professional accounting association	35 (31.3%)	84 (69.4%)	123 (51.5%)
Average not-for-profit sector experience	12 years	9.82 years	11.94 years
Average not-for-profit sector managerial experience	10.76 years	8.19 years	9.44 years
Public sector experience:			
Proportion	44 (38.9%)	39 (32.0%)	86 (35.7%)
Average years	12.65 years	9.50 years	11.11 years
Private sector experience:			
Proportion	66 (58.9%)	96 (78.0%)	167 (69.3%)
Average years	11.80 years	13.19 years	12.52 years
Level of annual revenue:			
\$1,000,001 - \$2,000,000	42 (37.2%)	27 (22.0%)	71 (29.3%)
\$2,000,001 - \$3,000,000	13 (11.5%)	6 (4.9%)	20 (8.3%)
\$3,000,001 - \$5,000,000	15 (13.3%)	13 (10.6%)	29 (12.0%)
\$5,000,001 - \$10,000,000	28 (24.8%)	27 (22.0%)	55 (22.7%)
More than \$10,000,000	15 (13.3%)	50 (40.7%)	67 (27.7%)
Percentage of revenue derived from government:			
0% - 20%	30 (26.5%)	26 (21.3%)	58 (24.1%)
21% - 40%	3 (2.7%)	14 (11.5%)	17 (7.1%)
41% - 60%	8 (7.1%)	13 (10.7%)	21 (8.7%)
61% - 80%	33 (29.2%)	26 (21.3%)	59 (24.5%)
81% - 100%	39 (34.5%)	43 (35.2%)	86 (35.7%)

Note: Of the 242 respondents, six classified themselves as not being managers or senior accountants, but in a role related to accounting or finance.

# Who should prepare compliant annual financial statements?

**Table 1: Thresholds for complying with Australian accounting standards**

	<b>Responses (%)</b>
All not-for-profit organisations	38.8
Not-for profit organisations with revenue of \$250,000 or greater	21.1
Not-for profit organisations with revenue of \$500,000 or greater	9.9
Not-for profit organisations with revenue of \$1,000,000 or greater	22.7
Other. Please specify	7.4

# Conceptual framework – Prior research

- **Accountability**
  - Over-riding objective of financial reporting in the NFP sector (Charity Commission, 2004; Connolly and Hyndman, 2013a; 2013b; Dhanani and Connolly, 2015; Hyndman, 1990; Hyndman and McMahon, 2010; 2011; Ryan et al., 2014 )
  
- **Decision-usefulness**
  - Now the sole objective of financial reporting in the for-profit sector (IASB, 2010; Ellwood and Newberry, 2016; Pelger, 2016)
  
- Therefore it is argued a common conceptual framework cannot meet the needs of the NFP sector (Palmer, 2013; Ryan et al., 2014; Sinclair et al., 2014, van Staden and Heslop, 2009)



## Conceptual framework – Prior research

- Submissions to the 2008 Australian Senate Standing Committee support NFP sector-specific accounting standards (Palmer, 2013)
- Sector neutral approach to standard setting is seen as being detrimental to financial reporting within the NFP sector and therefore detrimental to transparency within the NFP sector (Palmer, 2013)
- Submissions argue NFP sector specific accounting standards will accommodate the needs of the NFP sector and provide guidance on NFP sector-specific issues that are not considered in Australian sector neutral standards (Palmer, 2013)

# Conceptual framework – Results

**Table 2: Conceptual framework issues for accounting in the NFP sector**

<b>Statement</b>	<b>Disagree (%)</b>	<b>Agree (%)</b>
There should be a single conceptual framework that is equally applicable to both the for-profit and not-for-profit sectors.	39.0	45.7
A conceptual framework should acknowledge differences in the nature of operations between the not-for-profit and for-profit sectors.	9.3	77.7
For the purposes of not-for-profit organisations' reports, a conceptual framework should give primary importance to "accountability" over "decision making" purposes.	21.2	46.6
The sector neutral approach adopted by Australian accounting standard setters is appropriate.	32.0	55.4

Note: A five-point Likert scale is used. Scale (1) is strongly disagree, (5) is strongly agree. In this table, "Disagree (%)" represents those who responded either (1) or (2) on the scale and "Agree (%)" represents those who responded either (4) or (5).

# Conceptual framework – Results

**Table 3: Application of accounting standards to the NFP sector**

<b>Statement</b>	<b>Responses (%)</b>
A single set of accounting standards that are equally applicable to both the for-profit and not-for-profit sectors.	18.6
A single set of accounting standards that are applicable to both the for-profit and not-for-profit sectors, but with the issuance of extra standard(s) that deal with activities or issues specific to the not-for-profit sector.	24.6
A single set of accounting standards that are applicable to both the for-profit and not-for-profit sectors, but where appropriate extra paragraphs are included in accounting standards that deal solely with issues specific to the not-for-profit sector.	37.7
Separate sets of accounting standards, i.e., one set of accounting standards for the for-profit sector and another set of accounting standards for the not-for-profit sector.	19.1

# Usefulness of financial information - Prior research

- Accounting standard setters argue financial information contained in NFP financial statements are an important source of information (e.g., ASB, 2007)
- Academic research questions the usefulness of this information (e.g., Connolly and Hyndman, 2013a; 2013b; Connolly et al., 2013b; Hyndman, 1990; 1991)

# Usefulness of financial information - Results

**Table 4: Usefulness of information for decision-making within the not-for-profit organisation**

	<b>Disagree</b>	<b>Agree</b>	<b>Mean (SD)</b>	<b>Median</b>
Profit (surplus) or loss (deficit)	0%	97.9%	4.84 (0.42)	5
Cash surplus or deficit	0.8%	94.5%	4.72 (0.59)	5
Retained surplus or deficit (accumulated funds)	1.6%	92.1%	4.65 (0.69)	5
Revenues disclosed by program/ segment	2.2%	91.8%	4.60 (0.74)	5
Expenses disclosed by program/ segment	3%	91%	4.59 (0.77)	5
Maintenance expenses for assets	7.6%	80.5%	4.19 (1.01)	4
Amount (\$) of donations/grants received in cash	8.6%	80.2%	4.28 (1.09)	5
Amount (\$) of donations/grants received with restrictions placed on them	9.4%	79%	4.22 (1.12)	5
Amount (\$) of unrestricted donations/grants received	9.9%	77.8%	4.21 (1.18)	5
Depreciation expense for assets	11.3%	67.2%	3.87 (1.10)	4
Historical (acquisition) cost of non-financial assets	12.1%	65.1%	3.83 (1.12)	4
Liabilities disclosed by program/ segment	14.6%	64.7%	3.85 (1.25)	4
Replacement cost of non-financial assets	12.2%	64.2%	3.81 (1.16)	4
Amount (\$) of donations/grants received in kind	18.5%	60%	3.68 (1.25)	4
Market value of non-financial assets	17.7%	59.7%	3.69 (1.22)	4
Assets disclosed by program/ segment	19.6%	51.4%	3.54 (1.31)	4

Notes: Scale [1] strongly disagree – [5] strongly agree. In this table, ‘disagree’ represents those who responded either 1 or 2 on the response scale; ‘agree’ represents those who responded either 4 or 5 on the response scale.



# Usefulness of financial information - Results

**Table 5: Usefulness of information for external stakeholders**

	<b>Disagree</b>	<b>Agree</b>	<b>Mean (SD)</b>	<b>Median</b>
Profit (surplus) or loss (deficit)	5.1%	88.2%	4.49 (0.89)	5
Retained surplus or deficit (accumulated funds)	7.9%	79.2%	4.23 (1.03)	5
Cash surplus or deficit	10.6%	75%	4.13 (1.12)	5
Amount (\$) of donations/grants received in cash	21%	55.7%	3.63 (1.33)	4
Revenues disclosed by program/ segment	22%	55.1%	3.60 (1.32)	4
Expenses disclosed by program/ segment	23.8%	54.3%	3.58 (1.35)	4
Amount (\$) of unrestricted donations/grants received	23.2%	52.1%	3.53 (1.32)	4
Amount (\$) of donations/grants received with restrictions placed on them	25.8%	48.8%	3.39 (1.27)	3
Maintenance expenses for assets	27.2%	44.3%	3.29 (1.26)	3
Depreciation expense for assets	26.9%	42%	3.23 (1.23)	3
Market value of non-financial assets	31.4%	41.6%	3.13 (1.33)	3
Historical (acquisition) cost of non-financial assets	28.7%	41.3%	3.19 (1.22)	3
Amount (\$) of donations/grants received in kind	30%	38.8%	3.12 (1.30)	3
Replacement cost of non-financial assets	32.8%	38.5%	3.05 (1.30)	3
Liabilities disclosed by program/ segment	35.2%	36.1%	3.05 (1.39)	3
Assets disclosed by program/ segment	41.6%	26.1%	2.80 (1.34)	3

Notes: Scale [1] strongly disagree – [5] strongly agree. In this table, ‘disagree represents those who responded either 1 or 2 on the response scale; ‘agree’ represents those who responded either 4 or 5 on the response scale.

# Why do NFP organisations maintain an accounting system?

**Table 6: The importance of a not-for-profit organisation maintaining an accounting system**

	<b>Not Important</b>	<b>Important</b>	<b>Mean (SD)</b>	<b>Median</b>
a. Compliance purposes – i.e., to comply with Australian accounting standards and/or to satisfy the requirements of funding bodies	1.2%	97.1%	4.80 (0.54)	5
b. To provide information to assist in the running of the organisation	0.4%	97.9%	4.86 (0.42)	5
c. To contract with external donors (both current and potential)	20%	57.7%	3.61 (1.33)	4

Notes: Scale [1] not important – [5] extremely important. In this table, ‘not important’ represents those who responded either 1 or 2 on the response scale; ‘important’ represents those who responded either 4 or 5 on the response scale.

# Conclusions

- Over half of the respondents believe that NFP organisations with revenues in excess of \$250,000 should be required to prepare financial statements that comply with Australian accounting standards
- Support for a common conceptual framework somewhat mixed
- A conceptual framework needs to recognise the differences inherent in the NFP sector
- Accountability is an important objective of accounting in the NFP sector and needs to be included in the conceptual framework



# Conclusions

- Majority of respondents support a sector neutral approach
- Broad support for a single set of accounting standards
- But, where appropriate, this single set of accounting standards must have either:
  - Extra paragraphs included within accounting standards that deal with issues specific to the NFP sector (preferred approach)
  - Extra standards issued that deal with issues specific to the NFP sector
- The above findings are contrary to prior research
  - It is possible that respondents have become familiar with the sector neutral approach and as such accept it, or even see the benefits
    - I.e., a learning effect (Andriani et al., 2010, Kober et al., 2010)

# Conclusions

- Financial information seen as being useful for internal decision making but not as useful for external stakeholders
  - The lack of usefulness for external stakeholders is consistent with prior research
- This is consistent with our finding that maintaining an accounting system is seen as being important for providing information for internal decision making and compliance purposes

# Acknowledgements

- The authors wish to thank the AASB and ACNC for their assistance with this research.