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Australian Accounting Standards Board

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Reporting and Red Tape Reduction Directorate
Australian Charities and Not-for-profits Commission
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Dear Sir/Madam

2014 Annual Information Statement (AIS) Public Consultation Paper

The staff of the Australian Accounting Standards Board (AASB) is pleased to provide a submission to the abovementioned Consultation Paper. The focus of our comments is on issues in the Consultation Paper that we think are related to general purpose financial reporting. This is because, although the 2014 AIS is not purported to be a general purpose financial report, many of the proposals in the Consultation Paper appear to leverage off some aspects of general purpose financial reporting and we feel we can make the greatest contribution in relation to that aspect of the proposals given our field of expertise. Accordingly, we have not provided a response to all of the consultation questions.

We commend the efforts of the ACNC in developing this Consultation Paper. Our comments are provided in the attachment to this letter. In the main, our comments and suggestions relate to how we think the ACNC could consider using notions in Australian Accounting Standards in a way that may better meet the ACNC's objectives in seeking the information through the AIS. We have also made some suggestions for clarifying the proposed requirements in a way that might help avoid confusion.

If you have any queries regarding matters in this submission, please do not hesitate to contact Robert Keys – AASB Technical Director (rkeys@aasb.gov.au). Given the technical nature of many of the comments in this submission, the AASB would welcome the opportunity for its senior staff to meet with the ACNC to explain in greater detail some of the matters raised, to complement the staff-to-staff meetings that I understand have already been taking place.

Yours sincerely,

Kevin M. Stevenson
Chairman and CEO

Question 1

Do you agree that medium and large registered charities should separately disclose related party transactions in the AIS as proposed in Attachment (ii)? If not, what approach would you suggest and why?

We note that a requirement for medium and large registered charities to disclose in the 2014 AIS whether any related party transactions occurred in the financial year would be consistent with the requirements in AASB 124 *Related Party Disclosures* to disclose certain details about related party transactions in general purpose financial statements. Paragraphs 5-8 of AASB 124 provide a summary of the reasons why related party disclosures are useful to users of general purpose financial statements, and the ACNC might find that summary apposite for its own purposes and therefore helpful in explaining to its constituents why it is imposing a requirement about related party transactions.

We support the proposal to adopt the definition of 'related party transaction' from AASB 124 as the basis for an AIS financial reporting disclosure requirement, in the interest of not introducing another definition of the same term, which could otherwise potentially create confusion. However, we note that the definition in AASB 124 is extremely broad and therefore wonder whether a requirement to merely disclose whether any such transactions occurred would provide much information for ACNC purposes. Indeed, we would expect most charities to tick 'yes' to the proposed question, because most would be expected to at least have transactions with their key management personnel. If the response to an AIS question about related party transactions is meant to provide some kind of signal to the ACNC to potentially make further enquiries (or refer to the related party disclosure note in the general purpose financial statements, where such statements are available, of a registered entity), we suggest the ACNC further clarifies the nature of the transactions that are its primary concern (e.g. those transactions that were on terms that were not equivalent to those that prevail in arm's length transactions, which is a notion used, albeit in a different context, in paragraph 23 of AASB 124).[1]

As a final cautionary note on adopting the definition from AASB 124, we note that it includes a reference to 'reporting entity'. This reference may cause confusion due to the ACNC's focus on all registered charities (or, at least in relation to this proposed question, all medium and large registered charities), of which some might not be reporting entities. We suggest that the AIS make it clear that the reference to 'reporting entity' in the definition is to the registered entity, irrespective of whether that entity is a 'reporting entity' as defined in accounting standards.

Furthermore, just as an editorial comment, we note that the quoted objective of AASB 124 contained in paragraph 33 of the Consultation Paper is incomplete. The underlined text shown in the following has been omitted from the Consultation Paper: "…to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances<u>, including commitments,</u> with such parties."

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1 Furthermore, although paragraph Aus29.9.3 of AASB 124 *Related Party Disclosures* has been removed by AASB 2011-4 *Amendments to Australian Accounting Standards to Remove Individual Key Management Personnel Disclosure Requirements*, the ACNC might also find the notions in it useful in narrowing down the types of related party transactions it wishes to (or wishes not to) focus on. For example, that paragraph refers to characteristics such as 'terms and conditions no more favorable than ... if dealing at arm's length with an unrelated person', 'information about them does not have the potential to affect adversely ... the discharge of accountability ...', and 'trivial or domestic in nature'.

<u>Question 2</u>

Do you agree that small, medium and large charities should separately disclose information about their business activities as proposed in Attachment (i) and (ii)? If not, what approach would you suggest and why?

We note that a requirement to disclose whether, and if so, what type of business activities were undertaken during the financial year is broadly consistent with the requirement of paragraph 138(b) of AASB 101 *Presentation of Financial Statements* to disclose "a description of the nature of the entity's operations and its principle activities" and some of the notions in AASB 8 *Operating Segments* (albeit that standard is only applicable to a narrow range of reporting entities, which would not be expected to include charities).

We are of the view that, for the purposes of the AIS, 'business activities' could benefit from a definition that would limit the disclosure of immaterial business activities while still providing useful information that the ACNC requires to carry out its regulatory activities. In this regard, we note that AASB 8 paragraph 13 uses quantitative thresholds combined with a qualitative assessment of the relevant information:

AASB 8.13 An entity shall report separately information about an operating segment that meets any of the following quantitative thresholds:

> its reported revenue, including both sales to external customers and intersegment sales or transfers, is 10 per cent or more of the combined revenue, internal and external, of all operating segments;
> the absolute amount of its reported profit or loss is 10 per cent or more of the greater, in absolute amount, of (i) the combined reported profit of all operating segments that did not report a loss and (ii) the combined reported loss of all operating segments that reported a loss;
> its assets are 10 per cent or more of the combined assets of all operating segments.

Operating segments that do not meet any of the quantitative thresholds may be considered reportable, and separately disclosed, if management believes that information about the segment would be useful to users of the financial statements.

Whilst we do not necessarily advocate adopting an identical approach to meet ACNC purposes – ACNC might find it useful to consider the approach as a basis for more specifically identifying the information about business activities it wishes to collect.

We also note line item 3 in the proforma income statement in Attachment (iii) of the Consultation Paper asks for 'Revenue from providing services and sale of goods'. We suggest consideration is given to how that line item relates to the question about business activities. If the line item is only referring to revenue from business activities, then the question that is the subject of this specific matter for comment is arguably redundant. If, on the other hand, the line item is a broader notion, we suggest that is clarified to help avoid potential confusion.

Question 3

What information, if any, should medium and large charities be required to provide about reserves in the AIS? Why?

We note that, from a general purpose financial reporting perspective, equity is regarded as a residual, and sub-classifications of the residual are not a major focus. You might find paragraphs 65 and 66 of the AASB's *Framework for the Preparation and Presentation of Financial Statements* useful references in this regard. For example, paragraph 65 acknowledges that a sub-classification of the residual can be relevant to the decision-making needs of users of financial statements when they indicate legal or other restrictions on the ability of the entity to distribute or otherwise apply its equity. Those paragraphs acknowledge regulators (such as the ACNC) might have a role in determining whether particular types of reserves are to be maintained. Typically these relate to restrictions on the application of equity (eg whether it can be distributed to owners or not).

We also note that AASB 101 *Presentation of Financial Statements* requires the presentation of information about the components of equity, but at a relatively high level (see for example paragraphs 78(e) and 108 of AASB 101), unless greater detail is relevant to an understanding of the entity's financial position (per paragraph 55 of AASB 101 – see also our comments in the last paragraph in this section below).

In the absence of a regulator specifying the creation of reserves for a particular purpose, we question how useful information about the reserves created by a charity would be. In particular, it is unclear to us that disclosure of the three types of reserves referred to in paragraph 45 of the Consultation Paper (if these reserves exist for the particular charity) would provide an understanding of the "extent and nature of accumulated funds available" and "a charity's ability to utilise funds to meet debts". For example, in relation to the latter, as a residual, equity itself is determined as assets less liabilities and therefore, by definition, if it is positive implies that debts are 'covered'. We would expect that more direct information about restrictions on assets (such as that which would be provided by paragraph 74(a) of AASB 116 *Property, Plant and Equipment*; paragraphs 48 and 49 of AASB 107 *Statement of Cash Flows*; and paragraphs 14, 42D(c) and, more generally, 31 of AASB 7 *Financial Instruments: Disclosures*) might be more effective in providing the information being sought.

In relation to the specific mention of the asset revaluation reserve, such a reserve is used simply to balance the changes in value of assets that are measured at fair value in accordance with the option in AASB 116 *Property, Plant and Equipment*. Therefore, again, it is unclear to us that disclosure of the asset revaluation reserve would be useful for ACNC's stated purposes.

Furthermore, we are concerned that the references in the Consultation Paper to 'funds' in the context of reserve accounting could be misunderstood by less sophisticated users, leading to an inaccurate conclusion that any equity that is not described as 'restricted purpose funds' is readily available.

If the ACNC proceeds with its proposals relating to information about reserves we note that restricting a charity from disclosing a breakdown of its 'other funds' would not necessarily be consistent with general purpose financial reporting principles if such a breakdown would be relevant to an understanding of the charity's financial position (see paragraph 55 of AASB 101).

Question 4

Based on the current proposal in Attachment (iii) is there any additional financial information that you believe should be collected (or not collected) from small charities. Why?

Consistent with our covering letter, we have limited our responses to those questions in the Consultation Paper that we believe are within our field of expertise – that is, general purpose financial reporting by reporting entities. We understand that small charities are expected to be non-reporting entities preparing special purpose financial reports, therefore we do not make any comment in response to this question.

Question 5

Do you have any comments on the proposal to include optional financial questions in the AIS that charities can complete so they can meet any specific requirements of state, territory or Commonwealth agencies that also apply to them?

In broad terms AASB staff agree that, until there is greater alignment between the information needs of various agencies, the inclusion of optional financial questions would seem to be an efficient way for charities to provide information. However, consistent with the approach we have taken to responding to the Consultation Paper questions, we have not provided a detailed response to this question.

Question 6

What types of practical assistance (if any) would you like to receive from the ACNC to help your charity meet its financial reporting obligations to us? When you would like to receive this assistance?

Consistent with the explanation in our covering letter of the approach, we have taken to responding to the Consultation Paper questions, as we are focusing our responses on where we think ACNC could usefully leverage off general purpose financial reporting requirements, we do not make any comment in response to this question.

Question 7

Are there any other comments you wish to make about the proposed additional questions or financial information in this consultation document? Please be specific.

A) Information about groups

i) AASB members expressed their views about the proposed regulations relating to joint and collective reporting and the ACNC's focus on registered entities rather than the group in their comments (dated 1 February 2013) to Treasury on the Exposure Draft *Australian Charities and Not-for-profits Commission – Financial Reporting Requirements*. Given question 1 of the 2014 AIS asks whether general purpose financial statements have been prepared, we suggest that an additional question could be added to the Annual Information Statement that requests charities that prepare general purpose financial statements to also indicate whether the financial information included in their AIS is consistent with the consolidated information in their general purpose financial statements. We believe that significant confusion could be introduced among users if the financial information the ACNC publishes is prepared on a different basis than the charity's GPFSs without making this matter clear. Alternatively, the question could be along the lines of whether the registered charity has any controlled registered charities. This would provide a signal for someone interested in the group information to refer to the general purpose financial statements rather than relying on the (presumably unconsolidated) information published in the AIS.

B) The proposed pro forma financial statements

i) We note that the proposed formats of the pro forma financial statements are not purported to be consistent with general purpose financial statements. However, we have some concerns that their format could create some confusion for users. For example, the proposed format of the income statement in relation to expenses appears to have a mixed nature/function basis for classifying expenses (the QUT material on NSCOA similarly seems to adopt a mixed nature/function basis). This is in contrast with paragraph 99 of AASB 101, which requires an entity to present an analysis of expenses recognised using a classification based on either their nature or their function within the entity, whichever provides information that is reliable and more relevant.

ii) In relation to the absence of an explicit reference to fundraising expenses, while we are cognisant of the ACNC's reasons for such an omission from the current AIS, we do note that paragraph 85 of AASB 101 *Presentation of Financial Statements* requires that an entity shall present additional line items where such presentation is relevant to an understanding of the entity's financial performance. Furthermore, based on our preliminary research into service performance reporting, there are indications that information about fundraising costs would be useful to users of general purpose financial statements as it is integral to an understanding of a charity's financial performance.

iii) We suggest the ACNC give consideration to the AIS seeking an indication of the material accounting policy choices made in determining the amounts reported in the pro forma financial statements. For example, without knowing whether an entity elects to revalue its property, plant and equipment would make it difficult to compare the pro forma financial statements across entities. In this regard, we note that paragraph 112 of AASB 101 requires entities that apply Australian Accounting Standards to disclose notes to their financial statements that, among other things, explain the basis of preparation of the financial statements and the specific accounting policies used. We are of the view that without notes that describe the basis of preparation the usefulness of the financial information would be limited.

C) National Standard Chart of Accounts

While we understand that the ACNC is not responsible for the NSCOA, in the following we have highlighted some issues we have observed, which the ACNC may wish to provide some clarity on for its own purposes.

i) The following comments are in relation to Attachment (iv) of the Consultation Paper. Although not exhaustive, they hopefully provide some useful input to refining the material.

(a) Item 1 refers to recording income even if there is an obligation to supply some goods or services to the government. In general, the term 'obligation' is used to refer to a liability, therefore its use within the description of the income section might cause confusion. We also note, in contrast to the description in item 1, item 2-1240 contemplates 'Grants received in advance' being classified as liabilities where such grants received in advance would, depending on circumstances, be considered as income pursuant to AASB 1004 *Contributions*.

(b) Item 4's description requires a charity to record donations and bequests received in both monetary and non-monetary form. This appears to imply that voluntary services to a charity should be recorded as income, and we wonder whether that is your intention.

(c) Expense item 12 requires a charity to record all interest and debt servicing costs. This treatment might be inconsistent with AASB 123 *Borrowing Costs*, which requires such costs to be capitalised as part of a qualifying asset when they are directly attributable to the acquisition, construction or production of that qualifying asset.

(d) Items 8 and 13 refer to 'net' realised or unrealised gains and losses. Using the term 'net' while also presenting both line items in the financial report makes it unclear to us whether charities would be required to report only a single line item containing the net amount or if the gains and losses should be presented separately in the two line items. We note that paragraph 35 of AASB 101 states that "… an entity presents on a net basis gains and losses arising from a group of similar transactions …".

(e) Account 6-0030 *Amortisation Expense* has been included under item 14 *All other expenses*, it appears to us that this account would likely be more appropriately classified under item 11 *Depreciation and Amortisation*.

(f) Account 6-0040 *Assets Purchased < $5,000* appears to impose a rule relating to the materiality of purchased assets. We are concerned that this would be a significant departure from Australian Accounting Standards, which are principles based and would permit the preparer to exercise judgement as to whether an asset purchase is material or not. We note that the QUT material puts the < $5,000 into a context that is missing from the Consultation Paper. In any case, we are concerned with the emphasis on < $5,000 even within the QUT material.

(g) We note there appear to be inconsistencies in the use of the terms 'costs', 'expense' and 'paid' in the names of accounts. For example: accounts 6-0601 *S&W Annual Leave Expense*, 6-0612 *S&W Fees Paid*, and 6-0315 *Entertainment Costs*. The inconsistent use of these terms could create confusion as to whether the chart of accounts is consistently adopting appropriate accrual accounting language.

ii) The following comments are in relation to the May 2011 draft of the NSCOA as published[2] by the Queensland University of Technology – but, again, are not exhaustive.

(a) The fourth column of the NSCOA publication refers to 'IFRS Accounting Standards'. This reference is confusing as the AASB issues accounting standards independently in Australia (albeit incorporating IFRS), including additions for not-for-profit entities. However, the references for each NSCOA item refer to the AASB standards.

(b) The description of account 3-3000 *Asset Revaluation Reserve* references 'new Accounting standards'. We are uncertain as to which accounting standards this reference is intended to refer.

(c) 'Other comments' in relation to account 3-4000 *Other Reserves* are confusing and appear to imply that equity accounts should be used to monitor the allocation of funds within a charity. The reference to 'A reserve is essentially any amount of money specifically set aside …' is potentially confusing. (See also our comments in response to question 3 of the Consultation Paper above).

(d) We note that at item 4-0000 of the NSCOA reference is made to the fact that income and revenue are considered as equivalent. This equivalency is unfounded as the definition of revenue in AASB 118 is a subset of the definition of income in the AASB *Framework*. The key differentiator between revenue and other income is that revenue is the inflow of economic benefits arising from the **ordinary course of business** as defined in AASB 118. This key difference becomes increasingly important as charities would need to apply accounting standards in order to determine their size classification.

(e) 'Other comments' for accounts 6-0250 – 6-0290, relating to depreciation, contain guidance for the selection of a useful life of an asset with reference to Australian Taxation Office determinations. This prescriptive approach is inconsistent with general purpose financial reporting, which provides a definition of useful life in AASB 116 that is dependent on the intended use or production potential of assets.

2 https://wiki.qut.edu.au/display/CPNS/Standard+Chart+of+Accounts