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Comment Letter on AASB Discussion Paper: Development of simplified accounting requirements (Tier 3 not-for-profit private sector entities)

Our team of academic researchers from Edith Cowan University, Monash University, and Curtin University is pleased to comment on the Australian Accounting Standards Board's (AUASB's) Discussion Paper **Development of simplified accounting requirements (Tier 3 not-for-profit private sector entities)**.

Our views are formed on the basis of qualitative research using survey and interview data of stakeholders of the not-for-profit sector that was conducted at Edith Cowan University to offer an evidence-based voice on the standard-setting deliberations to the academic research literature.

The views expressed in the comments that follow are those of the research team at the three Australian universities and do not necessarily reflect the official position of the universities concerned.

If you have any questions about our submission, please contact Tricia Ong.

Yours Sincerely

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Comment Letter on AASB Discussion Paper: Development of simplified accounting requirements (Tier 3 not-for-profit private sector entities)

We begin by commending the Technical Team and Board members of the Australian Accounting Standards Board (AASB) for working on the project and drafting the discussion paper to address the challenges of financial reporting by not-for-profit entities. Small entities, many of which would lack the required resources, struggle to meet the demands of regulators and other stakeholders. We hope that our feedback will help shape the financial reporting of small not-for-profit private sector entities.

The below comments are based on our working paper “*Are charities and not-for-profit organisations (NFPOs) in Australia adequately prepared for new challenges in reporting obligations?*”. The project was funded by Edith Cowan University (ECU) Early Career Researcher Grant 2020 and completed in 2021. Our comments are informed by the statistical results from our research project that were based on a total of 135 online questionnaire responses completed by preparers and auditors of annual financial reports and other disclosure reports for charities and NFPOs in Australia. Other detailed results were collected through thirteen semi-structured interviews with preparers and auditors of those reports for NFPOs registered with the Australian Charities and Not-for-profits Commission (ACNC) under different categories of entities, including health care, social and public welfare, religious, and education. In our submission, we provide our opinion on questions 1, 5, 6, and 7. There is a need to more effectively and completely acknowledge the reporting differences and challenges among small, medium, and large NFPOs.

Question 1

Paragraphs 1.3 to 1.8 discuss the Board’s view that it should not develop ‘reporting thresholds’ to specify which reporting Tier that a not-for-profit private sector entity must, at a minimum, comply with in preparing financial statements.

Do you agree? Why or why not? If you disagree with the Board’s view, how do you propose the Board stratify entities amongst the available reporting tiers?

Comments on Question 1:

We argue that there is a need to develop standardised ‘reporting thresholds’ to specify the minimum required level of financial reporting for a not-for-profit private sector entity. These standardised reporting thresholds should be ones that can be applied consistently across different regulatory authorities. This is in line with stakeholders’ view that supports “a single set of objective reporting thresholds” (para 1.3) and is aligned with the Board’s views to have the reporting thresholds “to be more appropriately within the remit of the relevant legislation or regulatory authority” (para 1.4).

Having a comprehensive and standardised reporting threshold tier can provide better guidance to smaller NFPOs on their level of reporting requirements. Our study found that many smaller NFPOs have found it challenging to prepare financial statements without having more prescriptive guidelines provided in the current accounting standards. Many of these organisations lack accounting knowledge among their board members to have the capacity to exercise professional judgements on what and how to prepare financial statements that would be considered compliant. Besides, due to the nature of these small NFPOs, they cannot afford to recruit full-time accountants. These organisations that were also required to provide financial information and other reports to different government departments and regulatory authorities for funding applications and acquittals were frustrated that different sets of reports were required to be prepared, which increased their costs significantly. The inconsistent reporting requirements stipulated by different levels of Australian government authorities - federal, state (or territory), and local - have further increased the complexity of reporting, especially when the NFPOs operate across multiple states.

One of the key findings from our study was that many NFPOs did not see apparent direct benefits for the organisations when they are already required by the ACNC to provide more financial information and to have their accounts audited. This additional reporting was mandatory from NFPOs if their revenue was greater than \$250,000 according to the old threshold amount that was applicable before 1 July 2022 during our research period. While there was a consensus among the participants of our research project that increased transparency in the reporting of charities and NFPOs was necessary, many expressed concerns about the increased costs and challenges involved where financial and human resources were

required to prepare separate reports to their fund providers, with no effective streamline process in grant applications and reporting.

Our study finds that organisational size is one of the important determinants in the preparation of financial statements. Among many proxies, such as a total number of employees and total assets that are commonly used to represent organisation size, we argue that the use of total revenue/income as a reporting threshold determinant will be the most appropriate one in the context of NFPOs. This is because issues such as unaccounted volunteers and complexities in valuing donated assets that are eminent in NFPOs have made the proxies of a total number of employees and total assets inappropriate. Total revenue/income is also the easiest collectible and readily available data for all NFPOs, given that most NFPOs will already have this information collected. Hence, consistent with some support from the preliminary outreach (para 1.3b), we propose total revenue/income be used as the reporting threshold determinant.

While para 1.3b expressed concerns about the appropriateness of a quantitative threshold based on revenue/income, our research project has yielded contrary empirical results. Using the previous quantitative threshold specified by the ACNC at the time of our research, we used the total annual revenue to determine organisational size. We found that NFPOs of different organisation sizes experience significantly different levels of costs, challenges, and benefits adhering to the mandatory reporting requirements of ACNC. The details of the empirical results and the indicators used to measure costs, challenges, and benefits are attached and explained in the Appendix.

We agree that “any effort by the Board alone (to standardise the use of various accounting requirements) would not achieve the desired outcome” (para 1.3a). Hence, addressing issues and concerns mentioned in para 1.4 to 1.8, we propose that the Board develops standardised reporting thresholds using total revenue/income that is similar to that of ACNC to stratify NFPOs and specify the minimum required level of financial reporting for each stratified level of not-for-profit private sector entity. We advocate for this standardised reporting thresholds and their corresponding reporting requirements to be implemented consistently across other regulatory authorities, including the federal, state (or territory), and local, to allow a streamlined process in grant applications and reporting obligations of the NFPOs.

Question 5

Paragraphs 2.5 to 2.7 propose to extend the set of not-for-profit private sector entities to which Australian Accounting Standards apply by superseding (in part) SAC 1. The effect is that more entities will be required to prepare general purpose financial statements when required to prepare financial statements that comply with Australian Accounting Standards.

Do you agree with extending the set of not-for-profit private sector entities to which Australian Accounting Standards apply? Why or why not? If not, what alternative approach do you suggest?

We agree with extending the set of not-for-profit private sector entities to which Australian Accounting Standards apply. We support the Board's intention "to use the term 'reporting entity' to identify the boundary of the entity for which financial statements are prepared, consistent with its use internationally" (para 2.5).

Many of the NFPOs have ordinary and board members who do not necessarily have adequate accounting knowledge to understand the difference between special purpose and general purpose financial reports. Consequently, maintaining consistency in both the use of the term 'reporting entity' and the type of financial statements prepared is vital for NFPOs to avoid confusion about the already complex accounting standards. We agree that the Basis for Conclusions to AASB-2020-2 that details the reasoning to remove special purpose financial statements for certain for-profit private sector entities are equally applicable to NFPOs and hence should be applied consistently to NFPOs as proposed in para 2.6.

The results from our research provide empirical evidence indicating that preparers and auditors of many NFPOs are largely supportive of NFPOs to prepare general purpose financial reports over special purpose. While difficulties of initial implementation and challenges in providing explanations to NFPOs' members were common problems that emerged from our interviews with the NFPO preparers and auditors, there is unanimous agreement across our research participants that the benefits outweigh the costs for their organisations in the longer run. The use of general purpose financial statements has promoted consistency, transparency, and comparability for quality financial reporting. According to our interviewees, their organisations have seen many benefits with the adoption of general purpose reporting. Professional

accountants who usually support these smaller NFPOs through in-kind contributions or much reduced fees they charge for their services were now able to use the same generic accounting templates that they were using for their for-profits organisations or clients. NFPOs were also more supportive of upscaling their board members' skills and educating their members on financial reporting. On some occasions, the organisations were also able to use these financial statements in multiple regulatory submissions, resulting in cost and time savings. General purpose financial statements also ensure consistency in the preparation process, which consequently promotes comparability within organisations as well as comparisons with organisations in similar category groups. All these advantages from the adoption of general purpose financial reporting were good initiatives that have escalated improvements in NFPOs, improving the entire NFP sector.

The Board's call for the use of general purpose financial reporting is consistent with the findings from our research study. This provides supports for our advocacy for a better streamlined process for grants application, especially across the different government regulatory authorities, which would otherwise be unfeasible if NFPOs remained using special purpose financial reporting.

Question 6

Paragraphs 2.10 to 2.12 propose the introduction of a simpler further reporting tier (Tier 3) for not-for-profit private sector entities that are required to prepare financial statements complying with Australian Accounting Standards, which serves as a proportionate response for smaller sized entities with less complex transactions and events.

Do you agree? Why or why not? If not, what alternative approach do you suggest?

We support the Board's proposal for a simpler further reporting tier (Tier 3) for not-for-profit private sector entities that are required to prepare financial statements complying with Australian Accounting Standards. These reporting requirements should consider the organisational size to provide more prescriptive guidance for smaller sized NFPOs to simplify the process for proper recording of less complex accounting transactions and events.

Our research study finds that the organisational size of NFPOs has strong correlations with the level of benefits, challenges, costs and overall impacts experienced by the organisations when they were required to provide mandatory reporting to the ACNC. Through an online questionnaire, preparers and auditors of NFPOs were asked to respond using a 4-point Likert scale to gauge how significant each of the listed items in the different categories - benefits, challenges, costs, and overall impacts – have affected their organisations when mandatory annual reporting is required by submissions of an annual information statement (AIS). Details of the questions measuring each of these four categories and the respective statistical results are included in the attached Appendix.

We find NFPOs of different organisational sizes, according to their total annual revenue, have experienced significantly different levels of impact with increased mandatory reporting from regulatory authorities such as the ACNC. We present below a table of the summary results.

Size	ACNC (Threshold on annual revenue – before 1 July 2022)	Mean Rank			
		Benefits*	Challenges*	Costs*	Impacts
Small	Less than \$250,000	55.83	56.35	54.62	56.72
Medium	\$250,000 - \$999,000	75.48	75.48	74.88	74.39
Large	More than \$1 million	71.70	70.84	75.00	72.63

*Statistically significant at level 0.05 or lower.

We have found that medium sized NFPOs were the most impacted group size in three out of the four categories tested. The only category where it was ranked second was in the category of measuring the impact on the total cost. However, it is worth noting that the difference with the first rank was a negligible difference of 0.12. The results of this statistical test imply that medium sized NFPOs with an annual revenue of more than \$250,000 but below \$1,000,000 were the worse impacted group when increased mandatory reporting.

These statistical results from the questionnaires were consistent with the analysis of the data collected through our interviews. The medium sized NFPOs that rely largely on donations and volunteers for their reporting normally lack the financial and human resources to cope with the additional regulatory requirements. When the ACNC first introduced the reporting threshold in 2012, NFPOs classified as ‘medium’ in size were required to adopt general purpose financial reporting and have their financial statements audited. Consequently, increasing the impact on

challenges and costs. However, this new reporting requirement has also brought about more benefits to medium sized NFPOs. Hence, we support the Board's proposal to introduce a simpler further reporting tier (Tier 3) for not-for-profit private sector entities to assist these medium sized NFPOs in coping with the challenges and costs in implementing these new changes to improve the quality of their financial reporting.

Question 7

Paragraphs 2.13 to 2.17 discuss the Board's view to not develop a fourth tier of accounting for not-for-profit private sector entities.

Do you agree? Why or why not? If not, what alternative approach do you suggest?

Our study on different organisational sizes of NFPOs provides empirical evidence to support the Board's view that a fourth tier would create unnecessary complexity and confusion. Using statistical pairwise comparison to compare results of the different group sizes, we found significant differences largely between our small and medium sized NFPOs (i.e. total annual revenue below \$1 million). There were no significant differences when the organisational size increased beyond the medium group. With the new revised higher threshold revenue proposed for Tier 3, the differences are expected to be minimal.

Australian charities generating an annual revenue of less than \$500,000 are also likely to be considered less complex, with very different financial reporting needs among its users. Introducing another tier would require additional resources and time for the NFPOs to implement and understand, which may not add value for their stakeholders. The current three tiers of accounting standards provide sufficient guidance for not-for-profit organisations to report their financial information accurately and transparently.

Appendix

Category 1: Total benefits

(a) Extract of questionnaire on questions measuring total benefits

To what degree does the organisation benefit from the reporting of AIS?

	Significantly	Moderately	Marginally	Not at all
Meet stakeholders' demand for information	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Improve revenue	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Improve key financial ratios	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Improve decision making	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Improve the quality of financial reports	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Improve the use of technology and software system	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Improve preparation of the financial report	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Improve preparation for management report	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

(b) Summary of hypothesis test for total benefits and organisation size

Hypothesis Test Summary				
	Null Hypothesis	Test	Sig. ^{a,b}	Decision
1	The distribution of Total Benefits is the same across categories of ACNC Size.	Independent-Samples Kruskal-Wallis Test	.030	Reject the null hypothesis.

a. The significance level is .050.

b. Asymptotic significance is displayed.

(c) Result of pairwise comparisons – Total benefits and organisation size

Pairwise Comparisons of ACNC Size					
Sample 1-Sample 2	Test Statistic	Std. Error	Std. Test Statistic	Sig. ^{a,b}	Adj. Sig. ^c
Small -Large	-15.870	9.343	-1.699	.089	.268
Small -Medium	-19.658	7.612	-2.583	.010	.029
Large-Medium	3.787	8.898	.426	.670	1.000

a. Each row tests the null hypothesis that the Sample 1 and Sample 2 distributions are the same.

b. Asymptotic significances (2-sided tests) are displayed. The significance level is .050.

c. Significance values have been adjusted by the Bonferroni correction for multiple tests.

Category 2: Total challenges

(a) Extract of questionnaire on questions measuring total challenges

To what degree did the organisation experience the following challenges in adopting the new reporting requirements of AIS?

	Significantly	Moderately	Marginally	Not at all
Inadequate knowledge on AIS	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Lack of support from the organisation	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Complex reporting requirements	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Tax implications	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Difficulty in compiling information	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Adverse impact on revenue	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Lack of resources – manpower	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Lack of adequate technical system	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Inadequate timeline	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

(b) Summary of hypothesis test for total challenges and organisation size

Hypothesis Test Summary

	Null Hypothesis	Test	Sig. ^{a,b}	Decision
1	The distribution of Total Challenges is the same across categories of ACNC Size.	Independent-Samples Kruskal-Wallis Test	.039	Reject the null hypothesis.

a. The significance level is .050.

b. Asymptotic significance is displayed.

(c) Result of pairwise comparisons - Total challenges and organisation size

Pairwise Comparisons of ACNC Size

Sample 1-Sample 2	Test Statistic	Std. Error	Std. Test Statistic	Sig. ^{a,b}	Adj. Sig. ^c
Small -Large	-14.491	9.347	-1.550	.121	.363
Small -Medium	-19.136	7.615	-2.513	.012	.036
Large-Medium	4.644	8.902	.522	.602	1.000

a. Each row tests the null hypothesis that the Sample 1 and Sample 2 distributions are the same.

b. Asymptotic significances (2-sided tests) are displayed. The significance level is .050.

c. Significance values have been adjusted by the Bonferroni correction for multiple tests.

Category 3: Total costs

(a) Extract of questionnaire on questions measuring total costs

Indicate to what degree the organisation has engaged in the following resources to adopt the new reporting requirements of AIS?

	Extensively	Moderately	Occasionally	Not at all
Volunteers	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
External auditors	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Third-party assistance	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Web-based resources	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Internal staff	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Computer software	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

(b) Summary of hypothesis test for total costs and organisation size

Hypothesis Test Summary				
	Null Hypothesis	Test	Sig. ^{a,b}	Decision
1	The distribution of Total Cost is the same across categories of ACNC Size.	Independent-Samples Kruskal-Wallis Test	.016	Reject the null hypothesis.

a. The significance level is .050.

b. Asymptotic significance is displayed.

(c) Result of pairwise comparisons - Total costs and organisation size

Pairwise Comparisons of ACNC Size					
Sample 1-Sample 2	Test Statistic	Std. Error	Std. Test Statistic	Sig. ^{a,b}	Adj. Sig. ^c
Small -Medium	-20.257	7.603	-2.665	.008	.023
Small -Large	-20.380	9.332	-2.184	.029	.087
Medium-Large	-.123	8.887	-.014	.989	1.000

a. Each row tests the null hypothesis that the Sample 1 and Sample 2 distributions are the same.

b. Asymptotic significances (2-sided tests) are displayed. The significance level is .050.

c. Significance values have been adjusted by the Bonferroni correction for multiple tests.

Category 4: Total impacts

(a) **Extract of questionnaire on questions measuring total impacts**

To what degree does the organisation benefit from the new reporting requirements

	Significantly	Moderately	Marginally	Not at all
Meet stakeholders' demand for information	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Improve revenue	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Improve key financial ratios	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Improve decision making	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Improve the quality of financial reports	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Improve the use of technology and software system	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Improve preparation of the financial report	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Improve preparation for management report	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

(b) **Summary of hypothesis test for total impacts and organisation size**

Hypothesis Test Summary

	Null Hypothesis	Test	Sig. ^{a,b}	Decision
1	The distribution of Total Impact is the same across categories of ACNC Size.	Independent-Samples Kruskal-Wallis Test	.053	Retain the null hypothesis.

a. The significance level is .050.

b. Asymptotic significance is displayed.

(c) **Result of pairwise comparisons - Total impacts and organisation size**

Pairwise Comparisons of ACNC Size

Sample 1-Sample 2	Test Statistic	Std. Error	Std. Test Statistic	Sig. ^{a,b}	Adj. Sig. ^c
Small -Large	-15.908	9.364	-1.699	.089	.268
Small -Medium	-17.668	7.628	-2.316	.021	.062
Large-Medium	1.760	8.917	.197	.844	1.000

a.Each row tests the null hypothesis that the Sample 1 and Sample 2 distributions are the same.

b. Asymptotic significances (2-sided tests) are displayed. The significance level is .050.

c.Significance values have been adjusted by the Bonferroni correction for multiple tests.