

Feedback from AASB Roundtable Financial Reporting Framework – Not-for-Profit Private Sector Entities

Melbourne, 21 January 2016

About the Roundtable

Purpose

- 1 The purpose of the AASB Roundtable was to provide a forum to discuss issues and share views in relation to the Australian financial reporting framework, particularly in terms of the requirements for not-for-profit (NFP) private sector entities. The aim included discussing the way forward (a roadmap) for progress on this aspect of the AASB project, if the Roundtable considered there was sufficient scope for improvements in the application of reporting requirements to NFP private sector entities.
- 2 The agenda for the Roundtable is included in the Appendix to this summary.

Participants

- 3 As the purpose of the Roundtable was exploratory in nature, it was organised as an invitation-only session. Some organisations were represented by multiple participants. External participants were from:
 - State and Commonwealth regulators (7)
 - Audit firms (5)
 - Accounting bodies (2)
 - NFP entities (3)
 - Legal firms (1)

Summary

- 4 All participants agreed that it is unnecessary to require all NFP private sector entities to publicly lodge financial reports. However, participants emphasised that NFP private sector entities generally have different motives for publicly reporting their financial information as compared with for-profit entities. These motivations are based on a sense of accountability to the public for the use of donated funds or volunteered time. NFP private sector entities often feel the need to publicly report financial information to contribute to the transparency of the entity's activities.
- 5 However, over the course of the discussion participants expressed concern over the quality of information that NFP private sector entities make publicly available, and noted that there was scope for improving the application of reporting requirements to such entities. Participants suggested that the existing financial reporting requirements might be too complex for many NFP private sector entities preparing general purpose financial statements (GPFS), with the result that financial statements nominally prepared in accordance with Tier 1 or Tier 2 Australian Accounting Standards were not necessarily comparable across NFP private sector entities. Such lack of comparability would mean that one of the main objectives of general purpose financial reporting is not being met. Many entities produce special purpose financial statements

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(SPFS) instead, resulting in financial statements that are difficult to compare due to differing accounting policies and disclosures.

- 6 Discussions therefore considered simplifying financial reporting requirements for smaller NFP private sector entities, or adopting simpler terminology in accounting standards to improve the understanding of accounting standards. Representatives from State regulators noted that they require small NFP entities to report only selected financial aggregates (such as total assets, total liabilities, revenue and net profit) through a provided template (a financial summary), with no requirement to provide financial statements.¹ Participants raised the question whether Federal, State and Territory regulators could adopt a common simplified reporting template.
- 7 Given the possibility of harmonising simplified financial reporting requirements for small NFP private sector entities, participants considered the thresholds in place that require NFP entities to lodge financial statements rather than financial summaries. Participants noted that thresholds have been broadly based on those of companies limited by guarantee² and that it could be appropriate to increase those thresholds significantly.
- 8 The Roundtable agreed that the varying quality of general purpose and special purpose financial statements prepared by NFP private sector entities and lodged on the public record requires attention in terms of the Australian financial reporting framework. Participants agreed that a project to consider thresholds for financial reporting had merit and would be useful to improve financial reporting. As a first step the AASB should research thresholds applied in other jurisdictions. That project would need to be followed up with a consideration of the thresholds, and objective methods for determining the values of those thresholds, that could be used in Australia.

Is there a Financial Reporting Problem? (see Appendix, agenda item 2, for more detail)

- 9 The discussion began with the demographics of the not-for-profit private sector. All regulators present commented that the vast majority of NFP private sector entities fall into their smallest category. For most regulators this meant NFP entities with less than \$250,000 in consolidated revenue (or receipts).
- 10 Small entities are generally not required to submit financial statements to a regulator (they may have to submit selected financial information instead) but might still be required to prepare financial statements that give a true and fair view for their members. To achieve a true and fair view, it is general practice to apply Australian Accounting Standards. Entities that are not small are required to apply Australian Accounting Standards in preparing their financial statements. Given the small size of most entities preparing financial statements, participants noted a general concern about the complexity of Australian Accounting Standards for the NFP private sector entities that have to apply them.
- 11 Participants generally agreed that the quality of financial reporting across the sector is extremely variable and therefore might not be meeting user needs in some cases.

1 Some jurisdictions require even small entities to prepare financial statements (whether or not lodged publicly).

2 Companies limited by guarantee must lodge financial statements if their consolidated annual revenue is in excess of \$250,000.

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- 12 Some participants noted the difficulty of addressing this issue because many NFP entities view Tier 1 General Purpose Financial Reporting as an integral obligation arising from their fundraising activities. Sector-specific accounting standards were raised as a potential solution to this issue, but were not discussed further.
- 13 Overall, participants agreed that the current thresholds for financial statement preparation could be too low and that requiring all NFP private sector entities to prepare financial statements might not be necessary. Indeed, in some jurisdictions, small NFP entities are required to lodge with a regulator only a basic financial summary (without reference to Accounting Standards), and the templates for such summary information could form the basis for a simplified financial reporting model.

Reporting Aspects to Consider (see Appendix, agenda item 4)

- 14 Public accountability was raised as a key issue within the NFP private sector. Some participants noted a view among many NFP entities that being a beneficiary of public funds (whether donations or special tax concessions) automatically made the entity publicly accountable. Other participants supported public reporting based on the broader ‘economic significance’ argument or else argued that reporting to a regulator would be sufficient (and appropriate) where government assistance was involved. Ultimately, participants agreed that identifying user groups for an NFP entity could be difficult and may involve a joint effort in educating constituents on this topic.
- 15 Participants noted that the length of financial statements prepared in accordance with Australian Accounting Standards is a key deterrent to user engagement with those financial statements. In particular, extensive accounting policy notes and financial instrument disclosures were regarded as not useful to most users. Therefore, some participants suggested that a new tier of financial reporting could be established based on fixed accounting policies and minimal additional disclosure in the notes.
- 16 A range of views were expressed on the nature of the financial reporting requirements that might be included in a new Tier 3. For example, some participants queried whether simplification of the recognition and measurement requirements of Tiers 1 and 2 would be appropriate. Others questioned the target of a new Tier 3 – would it apply to small NFP private sector entities as a basis for preparing selected financial information, or to the smaller end of entities required to lodge financial statements? The latter approach would most likely replace the notion of special purpose financial statements as a public reporting option.

Objective Criteria/Thresholds For Reporting Tiers? (see Appendix, agenda item 5)

- 17 All participants noted that the ACNC and State and Territory regulators apply quantitative thresholds to determine the groups of entities that must publicly lodge financial statements. However, the basis for the current values for those thresholds was not clear.
- 18 The discussion therefore considered the metrics that could be used for reporting thresholds and the basis on which those thresholds could be set.

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Metrics that could be adopted

- 19 Entity revenue (or variants such as receipts) is currently the main metric in use. Participants raised concerns about revenue based on its volatility over time for NFP private sector entities, particularly if an entity received a large, one-off donation. Accordingly, if revenue was still to be a metric, participants noted that it may be preferable for entities to satisfy the threshold for a number of consecutive years before being considered to meet that threshold. Some regulators have developed exemptions that they may decide to apply when a revenue criterion is met by an entity in unusual circumstances.
- 20 Participants suggested that thresholds based on expenses, assets and number of members might be useful. Interpretive issues were raised with using expenses as a threshold, which could require clear definition to address ambiguities in the NFP context.
- 21 A total current assets threshold is currently used in New South Wales in conjunction with a revenue threshold to determine the financial reporting obligations of some incorporated associations. Many participants suggested that some form of total assets could be a useful threshold.
- 22 The number of members was also suggested as a metric on the basis that NFP private sector entities with fewer members would be likely to have less ‘economic significance’ and those fewer members might also be closer to the financial affairs of the entity. However, concerns were raised as to the interpretation of a ‘member’ in the context of a threshold. Some argued that donors may be seen by some as ‘members’ of an organisation. In other entities, the ‘members’ might be formally defined as the members of the governing body, rather than reflecting the people involved in some way with the entity. Such issues indicated that it might be difficult to make such a threshold workable.
- 23 Another approach raised to thresholds was to consider the possibilities for a mix or combination of factors, as illustrated by the NSW case above.

Basis for determining thresholds

- 24 Participants raised a number of mechanisms through which the values of the thresholds could be set. Among them were values based on an acceptable stratification of the population of NFP private sector entities lodging financial statements. For example, it might be considered acceptable that the top 5% of all NFP private sector entities should lodge Tier 1 general purpose financial statements, with 60% of all NFP private sector entities having to lodge only a financial summary. Some percentage in the middle could lodge Tier 1 or 2 financial statements, and the remaining percentage at the smallest end of the scale might not have any lodgement requirements.
- 25 Another suggestion was to consider thresholds relative to the NFP private sector contribution to GDP or relative to the cost of compliance for an entity to prepare financial statements. Relative thresholds gained significant agreement among participants because of their automatic adjustment as the economics of the sector

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change over time, and their potentially straightforward application where the underlying metric was well known.

Roadmap – Where to from Here? (see Appendix, agenda item 3)

- 26 Participants noted that legislation generally drives which entities are required to apply Australian Accounting Standards and to what level of accountability those financial statements should be prepared. Therefore, coordination with Federal, State and Territory Treasuries and regulators is imperative to this project.
- 27 Co-operation on research and consultation between major stakeholders on the topics of who has to report and what they have to report was greatly encouraged.
- 28 Participants generally took the view that the AASB was best placed to consider, with input from stakeholders and in conjunction with government policymakers and regulators, what financial information would be required when an NFP private sector entity is required to produce financial statements, if a further tier of requirements was to be introduced. However, the AASB would act in an advisory capacity to regulators as to the thresholds that might be put in place over which financial statements would be required.
- 29 **Timing.** Participants noted that the AASB would need to further consult with Federal, State and Territory Treasuries and regulators, which may impact timing. However, publications in mid to late 2016 would assist in taking the debate further.

Appendix: AASB Roundtable Agenda

Item	Topic
1	<p>Welcome and Introduction – Kris Peach, Chair, AASB</p> <p>AASB Australian financial reporting framework project</p> <ul style="list-style-type: none"> – work with government policymakers and other regulators – potential reforms re who should report and what should be reported – ensure benefits of financial reporting exceed the costs
2	<p>Is there a Financial Reporting Problem?</p> <p>General purpose and special purpose financial statements</p> <p>Variations across jurisdictions and regulators (benchmarking results)</p> <p>Benefits and costs of financial reporting</p> <ul style="list-style-type: none"> – too much or too little information? – consolidated versus entity reporting? – audit scope issues re controlled entities?
3	<p>Roadmap – Where to from Here?</p> <p>Who will take action?</p> <ul style="list-style-type: none"> – joint or individual action? – roles of national regulator groups, AASB, others? <p>What needs to be done?</p> <ul style="list-style-type: none"> – focus areas? – public consultation on proposals? <p>When should action be taken?</p>
4	<p>Reporting Aspects to Consider?</p> <p>Users of NFP private sector financial information?</p> <ul style="list-style-type: none"> – who are the users? – are they interested in group or entity information? <p>What information do they need?</p> <ul style="list-style-type: none"> – report from governing body/directors/management? – primary financial statements? – notes to financial statements? – selected financial information only ... and if so, what? <p>Tiers of financial reporting?</p> <ul style="list-style-type: none"> – Tiers 1 and 2 (RDR) – Tier 3 – simplified financial statements or selected financial information? – exemption from public reporting?
5	<p>Objective Criteria/Thresholds for Reporting Tiers?</p> <p>Economic significance</p> <ul style="list-style-type: none"> – how to determine? – annual revenue too variable? <p>Public accountability</p> <ul style="list-style-type: none"> – different levels of accountability? <p>Organisational characteristics</p> <ul style="list-style-type: none"> – own financial resources v. government grants v. private donations? – nature of programs?
6	<p>Summary and Concluding Remarks</p>