

# **Not-for-profit & Public Sector Reporting Research Horizons: Moving the Bar in the Right Direction**

**David Gilchrist  
(Curtin University)**

**Roger Simnett  
(UNSW Australia)**

# Aim of the Session



To identify issues and to provide evidence relevant to **standard setters** and **regulators**, as well as to **researchers** for future research opportunities, including:

1. which **entities** in the not-for-profit sector/public sector should lodge financial reports;
2. What should they include in their **reports**;
3. What are the **users' needs**;
4. How should the **accounting frameworks** for not-for-profit/public sector reporting be set?
5. Other **research opportunities**

# Public Sector and Charities (Not-for-profit) Sector

Both sectors are important, in size and nature, in the successful operation of a nation state

- Significant **commonality** in accounting and accountability research opportunities, as
  - **Interdependence**: these two sectors are inextricably linked, rely on each other in order to achieve their non-financial outcomes
  - **non-financial purpose**: “mission” for Not-for-profit organisations, and “policy objectives” in a public sector context
- **Economy, efficiency and effectiveness** are central to the accountability of these organisations, rather than just financial reporting



# Coverage in Research Paper



## 1. Types of organisations

### General Government Sector

which includes only those public sector agencies, such as departments of state

### Private Not-for-profit organisations (NFPOs)

including registered charities

- Years:** **last two decades** – as the main purpose is to identify topics for future research rather than seek to provide an exposition
- Country:** all of the research referred to is **Australian** unless specifically identified as otherwise

# Structure of the Research Paper

**1. Introduction**

**2. General Comments**

**3. Which entities should lodge financial reports**

**4. What should be contained in financial reports**

**5. Research and research gaps associated with user requirements**

**6. Issues surrounding reporting frameworks**

**7. Specific research issues**

**8. Concluding remarks**

# General Comments



- The themes focus on the key areas pertinent to **accounting**, as well as **sector specific themes**
- The **nexus** between the public sector and the Not-for-profit sectors is uniformly strong in the Australian jurisdiction
  - a small body of literature that focuses on the differences between the reporting of commercial activity and non-commercial organisations, such as *Cherny et al (1992)*, *Biondi (2012)*, *Van Staden and Heslop (2009)*
- **Research** has **expanded and intensified** over the last twenty years
  - For NFPs, the extant research has gradually expanded over the last twenty years, AND special editions of academic accounting journals have become more frequent
  - For charities, intensive research is resulted from the establishment of the ACNC, and the resultant available data for the charitable sub-sector
- Increasing emphasis is being placed on issues surrounding **extended external reporting**, such as performance reporting, outcomes reporting and mission accountability

# RQ 1: Which Public Sector Organisations Should Lodge Financial Reports?



- **Less complex** to determine compared with NFPs
- Each Australian jurisdiction has established a **legislative framework**: regulators (such as the Department of Treasury or Department of Finance), format of reports, content, certain aspects relating to preparation, timing.
- Requirement to lodge financial reports in the Australian context are driven by two essential features:
  - direct departmental accountability to the parliament
  - publicly accountable organisations
- The reporting and accountability process in modern Australian public sectors includes reporting of **Key Performance Indicators**
- There does **not** seem to have been an examination of the **need for all** public sector organisations to lodge reports, however, there are political implications

# Q2: What Should Be Included in NFPs Reports?



**Transaction Neutral paradigm** within which the Australian Accounting Standards are developed and applied means that the GPFAR of both Not-for-profit and public sector organisations are uniformly prepared and presented in the same context as those of the commercial sector.

- Kober et al (2016) survey of 242 senior managers and CFOs, 55% agree that sector neutral approach is appropriate

**This is an area that warrants further research.**



# What Should Public Sector Organisations Include in Their Reports?

- Content of the reports is generally prescribed by the **jurisdictional regulator** (that is, the Department of Treasury or Department of Finance), each such regulator develops a set of **model financial reports**
- Research evaluating the disclosure requirements of public sector entities in Australia is relatively limited, **further research** is required:
  - **specific content**: treasury officials raised the issue of some reporting elements that are relatively expensive to prepare but provide little if any relevant information, such as “Land Under Roads”, the categorisation of street verge trees as assets
  - **Reduced Disclosure Regime** in the context of red tape reduction for public sector agencies
  - whether **small public sector** entities with limited transactions and no quantitatively or qualitatively material assets should be consolidated into the Whole of Government reporting arrangements for a jurisdiction and whether they might use cash-based accounting (*Gilchrist et al. 2013*)

# Q3: What Are Users' Needs for Public Sector Organisations?

- **Parliamentary sovereignty:** Parliament is the formal recipient, a number of other sets of users including the responsible minister and the general community
- **Political nature** of the parliaments' oversight frameworks impact the ability of financial and other performance reports
- Issue of the ability to acquit has also been examined in the context of public sector audit and the accountability of parliamentary officers
- Added complexity associated with cultural differences, while there is limited work in the **operation of the acquittal frameworks** has been carried out in the **Australian** context.
- The accountability framework is also made complex because of the nature of the public sector/NFPs nexus
- Research areas relevant to the joint administration of public money in the pursuit of government policy:
  - **identification and allocation** of accountability expectations
  - the need to form an understanding of the impacts on both the public sector commissioners and NFPs providers in the context of those **impediments** that prevent policy becoming reality.



# Q4: How Should The Accounting Frameworks for Public Sector Be Set?

- There are **challenges** because: the accountability relationships are complex, the purpose is policy focused, current transaction neutral paradigm, nature of the public sector itself in terms of the universality of stakeholders
- Public sector financial reporting is within the accountability structure established under the Australian form of the Westminster system of government, both financial and performance accountability and acquittal have become increasingly important
- Interest in public sector accountability and acquittal focuses attention onto the more traditional accounting topics related to financial performance and financial position in the context of policy achievements, where the research tends to be complex
- **Specific accounting topics**, issue of **homogeneity**
- The **relevance and value** of accounting standards in differing countries in differing states of economic development
- **Quality** of financial reporting in the public sector
- A **sociological perspective** may inform standards setters, as the politicisation of the public sector

# RQ1: Which NFPs Should Provide GPFR vs SPFR

- Reporting entity - **GPFR** (general purpose financial reports)
  - Non-reporting entity - **GPFR** or **SPFR** (special purpose financial reports)
- \*AASB 1053 allows NFPs producing GPFR to meet Reduced Disclosure Regime (RDR) requirements

## RESEARCH SHOWS

- **Inconsistent** application of the reporting entity concept and the financial reporting choices between GPFR and SPFR
- **Unclear** as to what reporting entity concept being used, and why general movement to SPFR
- **Reporting burden** created by the differential reporting schemes for NFPOs in Australia

## RESEARCH OPPORTUNITIES

- **Why** choices are being made between GPFR and SPFR?
- **Implications** for financial report users.



**Table 1: A tiered approach to reporting responsibilities for registered charities**

**Do we have the tiers right?**

Size (50,908)	Discrimination by Turn Over	ACNC-Specific Type of Preparation and Reporting Requirements	ACNC Audit Requirement
Large (17.0% of ACNC charities, 4.0% >\$10m)	Revenue of \$1m or more	GPFR or SPFRs Accrual accounting Lodge financial reports via the ACNC portal	Audit must be completed by a registered company auditor
Medium (15.7% of ACNC charities)	Revenue of \$250 000 to less than \$1m	GPFR or SPFRs Accrual accounting Lodge financial reports via the ACNC portal	Can elect to have accounts either reviewed or audited
Small (67.3% of ACNC charities, 37.1% <\$50K)	Revenue < \$250 000	Cash or accrual Provide financial information via the Annual Information Statement Do not need to lodge financial report via the ACNC portal	No audit or review requirements

**Kober et al (2016) survey: Thresholds for complying with Australian accounting stds:**

**ALL NFP** **38.8%**  
**>\$250K** **21.1%**  
**>\$1m** **22.7%**



# Q2: What Should Be Included in NFPs Reports?

- ED 270 – Reporting Service Performance Information
- Social Impact Accounting Framework (*Adams 2016*)

Table 2: Social Impact Accounting Framework (*Adams 2016*)

Objective	User	Content elements	Qualitative Characteristics
Attract Resources	Funders	Report profile	Credible
Shape perceptions	Beneficiaries and communities	Organisation profile	Concise
Sector legitimacy	Other social purpose organisations	Social problem	Useful
Improve performance	The organisation and its staff	Social purpose	Understandable
Reflection and understanding	Third parties	Strategy	Participative
Accountability	No specific user	Activities	Meaningful
Control opportunism		Measured performance	Honest
Share learning		Attributable impact	Proportional
Sector effectiveness		Stories	
		Unexpected results	
		Learning and change	
		Methodology	



# Q2: What Should Be Included in NFPs Reports? (cont.)



- **Extended external reporting (related to ED 270)**
- Multiple capitals under **Integrated Reporting** type regimes, which contain a more balanced focus on social and other capitals rather than accounting profit, seems most applicable to charities.
- **Network of relationships**
- Many NFPs depend on a network of relationships (with other NFPs, businesses, government and philanthropists) whose contributions are not well captured by financial measures, yet are fundamental to their operation.
- The role of **volunteers** in charities- *ABS (2015)* indicated that volunteers in not-for-profit institutions provided over \$17.3 billion of unpaid labour in 2012-13. *Cortis et al. (2015)* found that more than 80% of charities engage volunteers.
  - **Research:** Little recognition of volunteer labour in financial reports, reflecting the unresolved relevance-reliability debate in the accounting profession.
  - Disclosure more prevalent on NFP websites compared to annual report disclosures.
  - Quality of disclosures and whether beneficial



## Q3: What Are Users' Needs?

- **NFPs** - organisation, the service recipients of those entities and their families, the communities in which they operate, government agencies that fund the services, sector regulators or the interests of the stakeholders of the organisations.
  - *Adams (2016)* identified a much broader range of objectives and user needs of external reporting and content elements than is generally considered in other conceptual frameworks



# Q4: Should NFPs have its own sector-specific standards, if so, who should set them

- *Kober et al survey: Application of accounting standards to the NFP sector*

Single set equally applicable to both FP and NFP sectors.	18.6%
Single set but with the issuance of extra standard(s) for NFP sector.	24.6%
Single set, but extra paragraphs included for issues for not-for-profit sector.	37.7%
Separate sets of accounting standards, for FP and NFP sectors.	19.1%

- Performance reporting: proposed performance reporting standard (ED270) focuses on a limited part of the complex practice of social impact accounting. As such, *Adams (2016)* identified a need for the AASB to at least be seen to **working closely with other sector-specific regulators**, such as the ACNC. Perception by many is that this is not occurring.

# Additional Specific Research Issues



## Misreporting and detecting financial vulnerability in Not-for-profit financial reporting. Can learn by identifying issues in audit reports.

*Yang et al. (2016)* examined audit reports of 1,686 large charities in 2014

- Major audit firms are Crowe Horwath (76 audits), KPMG (74 audits), Grant Thornton (70 audits), and BDO (64 audits). 13% chose a **Big 4 audit**
- Standard **unqualified** reports (81.58%), 10.04% **qualified** opinion and 8.38% have explanatory language. Main reason for qualification is completeness of revenue (over 80% of modifications)
- examined **going concern reporting** and found that 5.29% have going concern related language. Findings suggest a completely different propensity for issuing going concern audit opinions of auditors in the NFPs compared to capital markets (40% of Australian listed public companies in 2014 have going concern related audit report issues).

# Additional Specific Research Issues



## Administrative expenses in charities—fundraising costs and administrative costs

- While such disclosures are available in overseas jurisdictions, the issue of the proportion of administrative costs has been considered by the ACNC, but is not currently available in Australia.
- prospective intended and unintended consequences associated with reporting data related to the proportion of funds applied to administration as opposed to mission-focused activities.
- For instance, significant concern has been raised by sector regarding the consequences of creating league tables as a result of the reporting of this very general, high level indicator.
- **Research opportunity:** Much research in US currently focussing on this. What is included, and what is the unintended consequence?



# Additional Specific Research Issues

## NFP governance

- ACNC introduced a set of **governance standards** that charities must satisfy to retain their registration (2013).
- *Yang et al. (2016)* finds range of disclosed governance practices in AR for 1686 large charities. Provides future research opportunities.

---

Names of board members	1189	70.52%
Description of board members	576	34.16%
Distinguishing between non-executive members and executive members	142	8.42%
Number of board meetings	725	43.00%
Attendance rate of board meetings	718	42.59%
Presence of audit committee	290	17.20%
Presence of written policy of managing conflict of interest	721	42.76%
<b>Total</b>	<b>1686</b>	<b>100.00%</b>

---

# Additional Specific Research Issues

## Related party disclosures

- The 2015 ACNC report indicates that, among charities preparing general purpose financial statements which are required to adopt AASB 124, there exists extensive significant non-compliance.
- *Yang et al. (2016)* examined the disclosure of 1,686 large charities related party transactions and key management personnel compensation. Found that:
  - 43.83% charities have included a note of Key Management Personnel compensation in the financial statement;
  - 48.04% charities include a note of related party transaction
  - 35.82% of the charities have both disclosures.
- Further, 60% of GPFRs and 5% of SPFRs follow AASB 124.

# Concluding Remarks



- Area rich with current initiatives and research opportunities
- Importance for evidence-based regulation and standard setting has never been stronger.
- Recognise that researchers have not done a great job of aligning research with policy and standard-setting
- Need for all parties (professional bodies and firms, regulators and standard-setters, and academics) to best co-ordinate activities so as to:
  - better understand roles and constraints
  - identify research issues on areas of common interest
  - identify processes by which we can better work together, and
  - identify communication mechanisms for research findings.

# Contact details

Professor David Gilchrist  
Director  
Curtin Not-for-profit Initiative

[david.Gilchrist@curtin.edu.au](mailto:david.Gilchrist@curtin.edu.au)

Professor Roger Simnett  
Scientia Professor  
UNSW Australia

[r.simnett@unsw.edu.au](mailto:r.simnett@unsw.edu.au)