Australian Government

Australian Charities and Not-for-profits Commission

01 June 2017 Our ref: EXT2017/84

Ms Kris Peach
Chair
Australian Accounting Standards Board (AASB)
PO Box 204
COLLINS STREET VIC 8007

Dear Ms Peach

AASB EXPOSURE DRAFT ED 277 January 2017 - Reduced Disclosure Requirements for Tier 2 Entities

The Australian Charities and Not-for-profits Commission (ACNC) would like to thank you for the opportunity to comment on Exposure Draft 277 *Reduced Disclosure Requirements for Tier 2 Entities* (ED 277). We provide this letter which includes general comments and the attached appendix in which we address the specific questions raised by the AASB.

The scope of our review and commentary includes the following standards: AASB 12, AASB 15, AASB 16, AASB 101, AASB 107, AASB 108, AASB 116, AASB 124, AASB 136 and AASB 1054, while also considering the broader issues raised in ED 277. For your information, the ACNC regulates over 54,000 charities in Australia which are a sub-sector of the Not-for-profit sector. It is with regard to the impact of the proposed change on the charities sub-sector within which we frame our response.

The ACNC is the national regulator for charities with a focus on the following key statutory objectives for this important sector. This legislated set of objectives is outlined in Part 1-2 of the *Australian Charities and Not-for-Profits Commission Act 2012* (the ACNC Act 2012) and requires the ACNC to:

- maintain, protect and enhance public trust and confidence in the sector;
- support and sustain a robust, vibrant, independent and innovative sector; and
- promote the reduction of unnecessary regulatory obligations on the sector.

Based on our objects, the ACNC support the overarching principles the AASB have identified in applying the Reduced Disclosure Requirements (RDR) decision making framework, namely:

- that information provided in financial statements meets user needs; and

- that the benefits of providing the disclosures exceed the costs.

However, the 'user needs' terminology could be explored more fully, as the identification of the users of charity financial reports and the identification of their needs in terms of the content of such reports, is a fundamental precursor to being able to conduct a useful discussion pertaining to financial reporting requirements for charities. We also think that it is worthwhile considering the various characteristics relating to the breadth of experience and capacity regarding 'preparers' in greater detail as they could include a qualified Chief Financial Officer or a volunteer treasurer, with limited knowledge of accounting standards.

The ACNC acknowledges and emphasises the statement within the ED that the 'actual quantum of change is dependent on an entity's specific facts and circumstances'. This is particularly the case for the charity sector as it is an incredibly diverse and heterogeneous sector often operating in a very complex environment. As such, the reporting needs of these organisations are also diverse so that our comments regarding the identification of users and their needs is a critical part of achieving a balanced accounting standards framework that meets a cost/benefit calculus.

Each registered charity must provide the ACNC with certain information each year depending on the size of the entity determined by annual revenue. In relation to financial reporting requirements, the ACNC accepts three types of financial statements:

- General Purpose Financial Statements (GPFS);
- General Purpose Financial Statements - Reduced Disclosure Regime (GPFS – RDR); and
- Special Purpose Financial Statements (SPFS).

Breakdown of charities submitting GPFS and SPFS:

	2014	**2015**	**2016**
GPFS	66.7%	63.6%	62.4%
SPFS	33.3%	36.4%	37.6%

The 2016 data is based on 32 257 individual AISs submitted year to date. Final submissions for the 2016 financial year are not due until 30 June 2017.

The ACNC will continue to accept SPFS as this is prescribed in the legislative framework that was set by Parliament when the ACNC was constituted. The ACNC acknowledge that the AASB are looking to increase the uptake of entities moving from SPFS to GPFS. From an ACNC perspective, given the high percentage of SPFS preparers in the charity sector, we suggest that it is important to simplify the application of RDR and so we propose that further consideration be given to smaller entities and their reporting obligations. We also suggest that the description of the requirements of the standards could be simplified for better communication. For instance, a high level flowchart which could be used by an entity to consider the application and requirements of each accounting standard might further assist charities through the RDR. We believe this would be of great value to the preparers in charities as the RDR's may be clearer. If such a flowchart interacted with the appendix of each standard, the ACNC could see benefit in the RDR being shown as an appendix compared to the existing shaded display.

Case studies could also be provided to show the benefits of GPFS compared to SPFS, this has the potential to highlight possible intangible benefits of transitioning and taking some of the uncertainty away from the point of view of those charged with governance of charities.

The ACNC recognises in addressing the aforementioned objectives of the ED, that RDR in itself, may not motivate preparers to transition between reporting tiers, and we understand this ED is part of the AASB's larger project of simplifying and improving the financial reporting framework in Australia. We consider that the objective of the standard setter should be to reduce the reporting requirements as far as possible in order to reduce complexity, reduce preparation and assurance costs. We feel that the objectives within this ED and the aim to simplify the financial reporting framework in Australia as part of the larger AASB project are consistent with our view of the role of the standard setter.

Finally, the ACNC notes the timely release of the discussion paper 'Disclosure Initiative – Principles of Disclosure' published by the International Accounting Standards Board (IASB). Of particular relevance is the concept of balance and the discussion around the 'disclosure problem'. The paper details that financial statements often contain a mixture of the following: 'not enough relevant information', 'irrelevant information' and 'ineffective communication of information'. The paper also addresses the balance challenge faced by the standard setter in terms of being too prescriptive, not providing enough guidance and not allowing enough professional judgment. The ACNC notes that the AASB have considered the concept of balance in this ED.

The attached appendix provides the ACNC's detailed responses to the Specific Matters for Comment as set out in ED 277. Please note that these responses focus on the perspective of private not-for-profit entities and we have not considered the components or examples in ED277 that relate to public not-for-profit entities (i.e. government entities).

Please do not hesitate to contact Mel Yates, at Melville.Yates@acnc.gov.au should you have any queries in relation to the above.

Best wishes

Susan Pascoe

Susan Pascoe AM
Commissioner

Direct: 03 8601 9074
Email: susan.pascoe@acnc.gov.au

Appendix – Response to Specific Matters for Comment – ED 277

1. *Do you agree with the overarching principles on which the proposed RDR decision-making framework identified in the proposed joint Policy Statement is based (that is, user needs and cost-benefit)? If you disagree, please explain why (see [draft] joint Policy Statement paragraph 6 to this ED).*

   The ACNC agrees with the overarching principles on which the proposed RDR decision-making framework is based. The ACNC's own objects, one and three, support the same overarching principles; that is, there is a need to maintain and protect public trust and confidence by ensuring information provided in financial reports is useful, and that such reports enhance the knowledge of the public's understanding of these organisations financial operations. We also understand that some users of these reports will be seeking information that allows them to make decisions.

   However, a weakness in determining the requirements in any standard relating to financial reporting for charities lies in the fact that we do not have an adequate understanding of who the users are and what they need. As such, in order to better assess user needs, the ACNC suggest the AASB broaden the range of constituents consulted as outlined within the ED. Information was *'obtained from bankers, specialist practitioners who help businesses to avoid liquidation, business valuers, private equity investors and funders of not-for-profit entities'*. It would be beneficial to seek input from a wider spectrum of users representing the charity and not for profit sector. The ACNC recognises that the purpose of the ED is to receive such feedback and hopefully the feedback addresses the issue raised.

   The ACNC believes that the term 'benefit' needs definition and that this definition should be transparently shared. Commensurate with our concern regarding the identification of users and their needs, we would also ask: who the recipients of the benefit might be (the preparers or the end users). Often a benefit to the preparer (reduced disclosure requirements) is a cost (less information) to the end user and vice a versa.

2. *Do you agree with the two Key Disclosure Areas identified in the proposed joint Policy Statement as being essential for meeting user needs? If you disagree with either Key Disclosure Area (including any of the specific disclosures about transactions and other events significant or material to understanding the entity's operations as represented by the financial statements), please explain which one(s) you disagree with and why? (see [draft] joint Policy Statement paragraph 8 to this ED).*

   The ACNC agrees with the two key disclosure areas.

   Liquidity and solvency is of utmost importance in the charity sector particularly from a user's perspective. Revenue streams are often volatile for charities year to year and the sustainability of charities can often be misunderstood if referring only to the statement of profit and loss and other comprehensive income. So a focus on solvency and liquidity is supported by the ACNC.

Significant or material transactions or events also constitute a useful disclosure area and can be equally applied to entities independent of size. The absence of a threshold allows preparers to apply their own judgment in terms of materiality according to the nature of the entity and its operations. It is worth noting though that the capacity for professional judgment present in some charities may be lacking in the same way that it is probably lacking in terms of entities in the commercial and public sectors. Therefore, additional guidance may help charities and could take the form of case studies, guides on how to transition etc.

From a charity perspective, we believe that accountability and transparency should be considered as a key disclosure area. The principle being that financial information reported annually should accurately reflect the financial health or otherwise of an entity while decisions, actions and outcomes should be reported on and are able to be clearly understood by a user. In this way entities can be held to account for their actions. The right level of disclosure is central to good accountability and transparency in financial reporting. Given the previous discussion relating to the use of flowcharts, including accountability and transparency as a key disclosure area, might overcomplicate the application of a flowchart.

3. *Do you agree with the proposed joint Policy Statement as a whole **for determining RDR for Tier 2 entities**? If you disagree, please explain why (see the [draft] joint Policy Statement to this ED). In relation to the proposed joint Policy Statement, the **AASB is particularly seeking to know whether the disclosures required of not-for-profit entities are appropriate relative to the disclosures required of for-profit entities**.*

Not-for-profit private entities and public sector entities have different aims and missions compared to a for-profit entity. Private Not-for-profits also have differing disclosure requirements as compared to Public Not-for-profit entities. The key disclosure areas mainly focus on the profit and liquidity of the entity which is important for both for-profit and not-for-profit entities. However, the ACNC is mindful that the purpose of not-for-profit entities is to achieve objectives and outcomes that often come at the expense of making or increasing profit, therefore the sector may require disclosures more specific to the nature of their operations.

While the comparison between for-profit and not-for profit entities is worthwhile, it is important to remember that charities themselves are far from homogenous. Trust funds are typically asset rich, schools and churches often have a variety of income streams, some charities often operate on very small budgets, and users have a more equal interest in both financial and non-financial information.

The charity sector is motivated by mission and in this way is mission-centric rather than-profit centric, a charity's existence and purpose revolves around achieving non-financial outcomes.

4. *Do you agree with the approach in the proposed joint Policy Statement taken by the AASB regarding disclosures about accounting policies? If you disagree, please explain why (see [draft] joint Policy Statement paragraph Aus12.1 to this ED).*

   Yes

5. *Do you agree with the approach in the proposed joint Policy Statement taken by the AASB regarding guidance for disclosure requirements? If you disagree, please explain why (see [draft] joint Policy Statement paragraph Aus25.1 to this ED).*

   The ACNC generally agrees with reducing disclosure requirements for tier 2 entities where disclosure is encouraged rather than required for tier 1 entities. Guidance that is specific to disclosure requirements should be kept for tier 2 entities.

6. *Do you agree with the approach in the proposed joint Policy Statement taken by the AASB regarding cross-references to other standards that are general rather than specific? If you disagree, please explain why (see [draft] joint Policy Statement paragraph Aus29.1 to this ED).*

   This question is probably better answered by preparers of financial statements, however from an ACNC perspective we can see some value in cross-referencing to other standards. However, taking the holistic approach and in light of the purpose of the ED ultimately being about reducing information, the ACNC feel that the Aus paragraphs give enough guidance to appropriately apply the disclosure requirements.

7. *Do you agree with the outcome of the application of the proposed joint Policy Statement to the disclosure requirements in Australian Accounting Standards to determine the disclosures that Tier 2 entities should be required to provide? (see Proposed Tier 2 Disclosures) If you disagree with the outcome, please identify, with reasons:*

   (a) which disclosures that are identified as requirements that you believe Tier 2 entities should not be required to provide; and

   (b) which disclosures that are identified as concessions that you believe Tier 2 entities should be required to provide.

   The ACNC provides the following comments relating to each accounting standard that was examined:

AASB #	General Comments
12	Overall Comment The reduced disclosure requirements of this standard, results in a focus for tier 2 entities disclosing if there is a perception of control or otherwise. This is in contrast to the intent of tier 1 requirements, in that the objective of the standard is that an entity is to disclose information that enables users of its financial statements to evaluate: (a) the nature of, and risks associated with, its interest in other entities; and (b) the effects of those interest on its financial position, financial performance and cash flows. This appears to be a reflection of the reporting entity concept and user needs according to that concept, in which case the reduced disclosure for this standard is logical.
15	Overall comment From the proposed RDR, it seems there will be more disclosure requirements than the current RDR – mainly with the addition to comply with the disclosure requirements in paragraph 126. In addition it is noted that there are proposed RDR in relation to Appendix B Application guidance. From a preparer's perspective, it would generally be useful that the whole Guidance is kept to assist preparers in understanding the application of the standard.
16	Overall comment: The new Lease standard is intended to capture off-balance-sheet leases. While the new AASB1058 fills the gap in terms of recognising peppercorn leases, it is noted that the level of disclosure required under AASB 1058 is based on judgment as to the level of detail. The need to value and report on peppercorn leases is likely an additional and burdensome requirement. Not-for-profit private sector entities with normal market-value leases may find the new standard a significant reporting burden with explicit disclosure requirements. Nonetheless, the proposed RDR serves its purpose by including the key components to enable understanding in application of AASB 16.
101	Overall comment This standard is particularly hard to differentiate which parts of the standard is a presentation requirement and which is a disclosure requirement particularly where there are no headings like other standards have.
107	Overall comment The ACNC does not consider that the proposed RDR actually reduces the reporting burden for tier 2 and the appendix possibly overcomplicates the standard. It might be simpler to not differentiate between tier 1 and tier 2 for this standard, as the only paragraph that is not required for RDR entities is para 46. If a differentiation is still required, the shaded format would be much clearer than the appendix.
108	Overall comment The ACNC agree with the proposed RDR as it echoes the 2nd Key Disclosure Area and includes the main disclosure components for accounting policies, estimates and errors for users to understand applicable policies and changes (e.g. including changes in accounting estimates paragraph 40 which was not required under prior RDR).
116	Overall comment More disclosure is present in this standard compared to the current RDR.

124	Overall comment For most charities the proposed standard will not change any disclosures, however one change will affect some charities – Para 26 (& guidance 27) is now a tier 2 disclosure and will impact charities controlled or significantly influenced by government. The ACNC support related party transaction disclosure. The disclosure is consistent with the new framework and ACNC support its inclusion.
136	Overall comment From the proposed RDR, it seems there will be additional disclosure requirements than the current RDR – regarding paragraph 130 a disclosure requirement regarding impairment losses are of interest to users and increases the transparency.

AASB #	Paragraph	Additional Suggestion
101	25	Following the principles of the key disclosure area which includes liquidity and solvency of the entity; and transactions and other events that are significant or material to an understanding of the entity's operations as represented by the financial statements such as subsequent events, then issues of going concern would fall within those disclosure principles.
101	79(b)	This is particularly important for not-for-profit sector to be able to provide to the public the different restrictions on the reserves, whether restricted or unrestricted and or capital/building reserves which will provide more useful information to the public in assessing where an entity may hold high levels of reserves.
101	81A,82 and 85B	These paragraphs have already been included as one of the presentation paragraphs that RDR must comply with in paragraph AusB4. Whereas paragraphs 106 (Statement of changes in equity) and 111 (Statement of Cash flow) were not included as one of the presentation requirement to be included. It may be beneficial to list out all presentations in AusB4 and not just some.
107	39-42B	This section deals with control and changes of ownership issues, and all are now requirements due to paragraph 39 being a presentation requirement and paragraph 40 being a key disclosure area due to liquidity issues. As these paragraphs are now requirements, paragraphs 39-42B are required for tier 2 as these paragraphs provide guidance and clarification to paragraphs 39 and 40. This makes sense, but perhaps it does not need to be specifically listed in the appendix as a requirement, without it the reader would assume it is a requirement for both tier 1 and tier 2.

107	50, 51 and 52	Paragraph 50 is encouraged, therefore it is not really a requirement for tier 1 and it is hard to argue that if this is not a requirement for tier 1 then the burden is reduced for tier 2. Paragraphs 51 and 52 are guidance paragraphs rather than requirements; again it would be hard to argue that this reduces the reporting burden for tier 2, when it is not a requirement for tier 1.
116	73(a)	ACNC feel this should be kept for RDR primarily as the 'gross carrying amount' is referred to in 73(d) and 73(e) (vii). It would make sense then that the measurement basis used for determining gross carrying amount to be disclosed, to give context to the other disclosure requirements.
1054	10	The cost of providing the disclosure of audit fees should be minimal. The question is more around the benefit of disclosing audit fees. The ACNC does not see it being a requirement if it is not a material transaction.

8. *Which approach do you prefer for identifying RDR for Tier 2 entities?*

   (a) the approach taken in this ED with the Proposed Tier 2 Disclosures to include an Australian Appendix in each Australian Accounting Standard that identifies the disclosures that Tier 2 entities are required to provide; or

   (b) use the approach taken in the New Zealand ED to use an asterisk (*) for disclosures that are not required and explaining partial concessions by means of an RDR paragraph? The approach taken in the New Zealand ED is illustrated in the Appendix A to this ED.

   The ACNC see benefit in the use of an appendix but not as a standalone reference guide. Ideally the appendix should be used as part of a flowchart interacting with the RDR decision making framework. As mentioned earlier, the ACNC has reviewed the ED from an analytical perspective and more consideration should be given to the needs of those that prepare financial statements.

   An issue with an Appendix is that it will lengthen the standards with duplicated information for tier 2 entities repeated in the Appendix. Also the approach may limit tier 2 entities to only focus on the disclosures in the Appendix and would not refer to Tier 1 entities' requirement whereas the current adopted approach may still encourage preparers to read the unshaded disclosure requirements.

   It is worthwhile noting, that if the appendix is a standalone reference guide we would prefer the existing shaded method to identify RDR. The main reason for this is that entities would still be required to navigate to the main body of the standard to read the recognition and measurement requirements.

   In particular AASB 101, we found it difficult to differentiate which paragraphs were guidance/presentation requirements from the disclosure requirements especially if the proposed Appendix method was adopted.

9. *Do you agree that when an Australian Accounting Standard does not have separate sections for disclosure and presentation requirements, both presentation and disclosure requirements are included in the Australian Appendix to each Australian Accounting Standard that identifies the disclosures that Tier 2 entities are required to provide? If you disagree, please explain why.*

   This approach will make accounting standards rather lengthy as it presents the same if not similar information in the Appendix which has previously been stated in the body of the standard for tier 1 entities. But given that some standards do not differentiate between disclosure and presentation, including in the Appendix seems logical.

10. *Do you agree that, once approved, the amended Tier 2 disclosure requirements should be effective for annual periods beginning on or after 1 January 2019 with early application permitted? Early application is permitted for periods beginning on or after 1 January 2018 (with early adoption of the amended Tier 2 disclosures in AASB 140 Investment Property permitted when an entity first applies AASB 16 Leases), with AASB 101 Presentation of Financial Statements, AASB 107 Statement of Cash Flows and AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors as revised by this [draft] Standard applied at the same time an entity first applies a Standard that is revised by this [draft] Standard.*

    ACNC see no issue with the effective date or the early adoption option.

11. *The Exposure Draft does not propose any specific transition requirements. Do any issues warrant transitional provisions and, if so, what transitional provisions do you suggest?*

    ACNC see no requirement for any transitional arrangements.

12. *Do you think that when approved, the amended Tier 2 disclosures would encourage eligible entities that currently:*

    (a) prepare Special Purpose Financial Statements to prepare Tier 2 General Purpose Financial Statements; and

    (b) prepare Tier 1 General Purpose Financial Statements to prepare Tier 2 General Purpose Financial Statements.

    The ACNC do not believe that the proposed ED will encourage eligible entities to move from SPFS to tier 2 GPFS – RDR, primarily as the benefit of transitioning is not well understood from a preparer's perspective.

    There is scope to highlight what is required to transition and perhaps a workflow chart showing how the RDR decision making framework functions this may simplify the process by which entities can transition.

The ACNC do not believe that tier 1 preparers will move to tier 2, particularly as RDR has a stigma of being not as good as full GPFS.

13. Whether:

(a) there are any regulatory or other issues arising in the Australian environment that may affect the implementation of the proposals by not-for-profit entities, including any issues relating to public sector entities, such as GAAP/GFS implications?

(b) overall, the proposals would result in reporting that would be useful to users?

(c) the proposals are in the best interests of the Australian economy?

No further comment