Voiceover: Hello, and welcome to the CPA Australia podcast, your weekly source for accounting, education, career and leadership discussion.

Ram : Welcome to the CPA Australia not for profit podcast series. In this series we discuss some of the key issues for those working in the not-for-profit sector, covering a different topic each podcast.

Ram : Today's topic is 30th of June, 2019, year end financial reporting tips for not-for-profits. I'm Ram Subramanian, policy advisor in reporting at CPA Australia. Joining us today is Peter Shields, audit principle and not-for-profit specialist at Saward Dawson.

Ram : Saward Dawson is recognised across Australia as a firm specialising in the not-for-profit sector, providing it services across all states and territories. Peter leads the audit division at Saward Dawson and counts many non-for-profit clients within his portfolio.

Ram : Peter is here today to talk to us about some of the issues that may need to be considered by not-for-profits when preparing financial reports for 30th of June, 2019, year ends. Welcome Peter.

Peter: Thanks Ram.

Ram : Peter, a number of new accounting standards have come into effect in the last a year or two. For those not-for-profits that have to prepare financial reports that comply with Australian accounting standards, could you provide some insights into which accounting standards specifically apply to the current year ended, 30th of June, 2019, that we are considering today?

Peter: Sure. There've been a number of changes in the last few years in relation to accounting standards that will have application dates that are fast approaching. The key standards that urgently need to be considered for not-for-profit entities with year ends ending 30 June, include firstly AASB 9 Financial Instruments.

Peter: This standard first applies for year ends ending 31 December for not-for-profits, but will also apply to year ends ending 30 June. The requirements of this standard is significantly different in relation to the allocation of fair value adjustments, that is unrealized gains and losses between the profit and loss and other comprehensive income, as well as changes in terminology and a revised disclosures.

Peter: In addition, there are irrevocable choices to be made by investment instrument. A common error in the 31 December accounts was the treatment of managed funds as an equity instrument. Managed funds are not equitable for recognition via other comprehensive income, and therefore need to be recognised directly through profit and loss.

Peter: Another standard that comes into effect in the following year is AASB 15, revenue from contracts with customers. This has an application date that will first apply to not-for-profits for the year ending 31 December 2019, and apply for other not-for-profits for 30

June 2020. This standard will see the introduction of a significantly different five step process for revenue recognition that will in many cases see the deferral of revenue and associated expenses.

Peter: Revenue streams will need to be critiqued and analysed. AASB 1058, income of not-for-profit entities also applies for the first time for years beginning on or after 1 January 2019. As such, it'll first apply for 31 December 2019 year ends, and apply to non-for-profit entities for 30 June 2020. This standard covers income that is not accounted for under AASB 15, revenue from contracts with customers.

Peter: This standard includes the option to recognise volunteer labour as a revenue item. Another standard that first applies for years ending on or after 1 January 2019, is the standard AASB 16 on leases. This standard removes the current distinction between operating and finance leases, and for the first time we will see property leases being capitalised as a right to use asset, whereas previously for the financial report would have only included rental payments and commitment disclosure.

Peter: Not-for-profit entities can consider early adoption of a number of these standards. However, it's important to note that a number of the standards are linked such that they must be early adopted at the same time.

Ram : So you talked about AASB 15, AASB 1058 and AASB 16 all coming into effect from the 1st of January 2019, that's their effective date. And you also mentioned that these are going to really affect not-for-profits with December year ends for the first time on the 31st of December 2019.

Ram : So that would be the first full year when these standards kick in, and many not-for-profits which have a June year end, the first time it would kick in would be before 30th of June 2020 year ends. So some might argue that this is still a little way away from where we are right now. So does this mean that not-for-profits do not have to worry about these standards at this point in time?

Peter: Absolutely not. There's a lot of work to be done in preparation for the application of the standard, and specifically in 30 June 2019 financial statements, AASB 108 requires disclosure in relation to new standards that have been issued but are not yet effective.

Peter: It also includes a requirement to disclose known and reasonable estimatable information relevant to assessing the possible impact, and it's important to note compliance with this standard is required under the ACNC legislation. In order to achieve the AASB 108 disclosure, the following implementation process will need to be considered.

Peter: Firstly, awareness of the changes is going to be important for organisations. Secondly, the application will need to be determined for not-for-profit entities. For entities preparing special purpose financial reports, they will need to consider whether there is a statutory obligation to comply with these new standards or part thereof and they will need to consider the needs of the various stakeholders in order to determine which of the new standards should be adopted.

Peter: There'll be a need for education and planning in relation to the project management of the new standards. They'll need to consider the transition obligations and the opportunities for concessions in the transition. Not-for-profit organisations will also need to consider the transitional provisions under AASB 1, and the transitional provisions available under the accounting standards.

Peter: In addition, we also find there's the need for communication with both the board and stakeholders. Communication with the board, the board may not always be across the requirements of the new standards and we always recommend that when there's a significant change in accounting policies due to accounting standards, that a paper is prepared outlining the requirements of the new standard and any other application matters for the board to approve.

Peter: Communication with stake holders will also be critical, as many of these standards will change how the financial statements are presented and the information contained therein. It is also important to remember stakeholders such as banks may have covenants in place and we're expecting to see increased volatility in the profit and loss statement and new types of assets and liabilities being recognised.

Peter: There are also a number of options under the new accounting standards that will require a policy decision in relation to which option is selected. As I mentioned before, this information is best summarised in a board paper to support the adoption of each standard.

Ram : As an auditor of not-for-profit financial reports, you're probably encountering a number of concerns or other issues that you would like to see some improvement on within the financial reports. Perhaps if you could just highlight, say the top five issues that you think are of most importance within financial reports of not-for-profits that you've audited?

Peter: Sure. I think to encapsulate the main issue is the understanding of whose responsibility it is to prepare the financial reports and apply the accounting standards. I think broadly there's a misunderstanding that the responsibility of the new accounting standards is that of the auditor's.

Peter: Both ASIC and the ACNC have made it clear recently that it is actually the responsibility of the board in preparation of the financial reports, rather than the auditor. So to name five points, I think there's a need for not-for-profit entities to document and understand their own reporting status. That is whether they're going to prepare general purpose financial reports or special purpose financial reports.

Peter: Understanding the application details of the new accounting standards would be critical and to which year they apply, particularly for 30 June 2019 the requirements of AASB 9, financial instruments. Thirdly, ensure the board are engaged and educated in relation to the requirements of the financial report and are part of the decision making and approval process.

Peter: Fourthly, we recommend that you engage with your auditor early and keep them informed of the implementation work you're undertaking. Be prepared to invest some time and probably money in getting the right advice when preparing for the application of the new standards. And then finally ensure that you don't neglect preparing a quality year end audit file whilst focusing on the new accounting standards.

Ram : Thanks, Peter. Maybe if we can move on to the role of the ACNC as the national regulator for charities. Now in that position, the ACNC has been monitoring the quality of charities reporting, including the financial information provided by charities in the annual information statement and the financial reports that are provided by medium and large charities.

Ram : Could you perhaps highlight some of the errors and other issues that the ACNC has identified through their review, so not-for-profits can perhaps focus on these issues for the 30th of June 2019 financial reports?

Peter: Sure. Interestingly, the ACNC have reviewed the 2017 financial reports on a sample basis and found significant issues in relation to a number of areas.

Peter: They haven't made it clear whether it was in the annual information statement or the annual financial reports, but they do highlight the fact that there are a number of entities incorrectly classifying themselves as basic religious charities and therefore not complying with the financial reporting requirements.

Peter: There were also adjustments that they report totaling $20.7 billion in relation to revenue recognition, and adjustments to recognition of assets totaling some $670 million.

Ram : Those are big numbers, aren't they?

Peter: Very large numbers. The ACNC have also issued a checklist outlining their focus areas for 2019, which should be considered by all charitable entities. The checklist is available from the website and will focus in the following areas.

Peter: Inclusion of all notes required by the accounting standards, inclusion of comparative information, disclosure of significant accounting policies, appropriate disclosures of estimates, judgements and errors, and disclosure of audit fees were required. Also the inclusion of an audit report or review report signed by an appropriate auditor or reviewer.

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Ram : Looking at other regulators other than the ACNC, obviously there are many, many regulators looking after the not-for-profit sector across the spectrum in Australia.

Ram : Are there any specific issues not-for-profits should be looking out for when complying with financial reporting or other obligations they will have with other regulators? So this is regulators other than the ACNC.

Peter: Sure. I think one of the things to remember is that companies limited by guarantee that are not charities continue to be regulated by ASIC under the Corporations Act. They have different reporting requirements and have covered off on the key requirements under policy statement 85 in relation to the requirements for special purpose financial reports.

Peter: ASIC have also issued a summary of their focus areas for years ending 30 June 2019, and have explicitly named the new accounting standards and the disclosures in relation to the impact of the new standards, accounting estimates, accounting policy choices including revenue recognition, expense deferral and off balance sheet arrangements.

Peter: And it is also worth pointing out that regulatory guide 85 sets out the expectations for companies preparing special purpose financial reports and names financial instruments, lease accounting, employee entitlements, consolidated financial statements and related party disclosures, as areas that may need to be covered to ensure the accounts are true and fair.

Peter: Not-for-profit entities that are incorporated associations should also review the financial reporting guidelines issued by the various regulators.

Ram : Thanks Peter. Coming back to the ACNC, as part of it's a red tape reduction measures, the ACNC has implemented transitional reporting arrangements with several government agencies both at the Commonwealth level and the state territory level.

Ram : The ACNC has also implemented various streamlined reporting arrangements in addition to the transitional reporting arrangements. Could you explain the difference between transitional and streamlined reporting arrangements, and what this means for not-for-profits when they are preparing and lodging financial reports with the ACNC or other regulators this year?

Peter: Sure. So we're talking here about charities reporting under the ACNC as opposed to other not-for-profit entities. Firstly, in relation to the transitional provisions, when the ACNC first came in, there were concessions by way of transitional provisions put in place to avoid the need for double reporting or certainly reporting with two sets of financial reporting obligations.

Peter: To minimise the reporting burden on charitable entities that were incorporated under other jurisdictions, the ACNC has allowed those existing financial reporting obligations to meet the requirements of the ACNC. The financial statements have been deemed to comply with the requirements of the ACNC. It's important to note these transitional provisions have only been extended to the 2019 financial reporting periods.

Peter: There are other transitional provisions that apply to other Commonwealth agencies, including the Register of Indigenous Corporations, Department of Education and Training, and in certain circumstances, reporting under the Australian Taxation Office. This brings us to the streamlined reporting.

Peter: Streamlined reporting in principle is a single lodgment of a financial report that is then shared with other regulators. The majority of the states have streamlined their reporting arrangements, and charities will only have to prepare and lodge one financial report in accordance with the requirements of the ACNC, and this will satisfy the obligations of the state regulators.

Peter: One of the critical elements of financial reporting obligations under the ACNC relates to the level of assurance required. The ACNC requires audits to be undertaken by a registered company auditor, an audit firm, or an authorised audit company. It is important that action is taken to ensure that your auditor satisfies these obligations as there is a possibility you will need to change your auditor, and this may take time and result in higher costs.

Peter: Reviews for medium sized charities can be undertaken by a current member of a relevant professional body. I strongly recommend that incorporates associations, cooperatives and other regulated entities that have separate financial reporting obligations, review the transitional provisions set out on the ACNC website.

Ram : Thanks for that Peter. Moving on. Many smaller not-for-profits and charities are not required to comply with Australian accounting standards when they prepare their financial reports in order to comply with statutory obligations. Could you perhaps highlight any specific matters such smaller entities should look out for when complying with their obligations?

Peter: Thanks Ram. Smaller not-for-profits and charities that fall below the regulator reporting thresholds will typically need to also consider whether they have a constitutional requirement. Often constitutions or rules will require the preparation of a financial report, sometimes in accordance with accounting standards, and also may require that the financial report must be audited.

Peter: The reporting entity concept must also be considered in determining who the users of the financial report are and what financial information they may require. Other stakeholders including banks and other lenders, and more frequently donor requirements, will often include the requirement for an audited financial statement.

Ram : Thank you Peter. Looking ahead a bit, so moving on from 30th of June 2019 year ends perhaps, looking a bit towards changes that may be coming into play in the near future. The Australian Accounting Standards Board is proposing to require entities to disclose information about their compliance with the recognition and measurement requirements of Australian Accounting Standards. What are your thoughts on this proposed change, and how is it likely to impact not-for-profit reporting?

Peter: Thanks Ram. Firstly, I think the proposed change is positive. This is a recent announcement for entities preparing special purpose financial reports and additional disclosures that may be required. The first element is a background in relation to the reporting entity concept.

Peter: Australia is set apart by having a reporting entity concept that allows preparers of financial reports to determine the level of disclosure with the accounting standards in certain circumstances. The Accounting Standard Board have been very transparent in relation to their desire to move away from this concept and have been working with various stakeholders, reviewing international models and building the case to move away from this reporting entity concept.

Peter: The AASB has also been considering what concessions and options should be available under the accounting standards for not-for-profit entities. Whether you agree that the reporting entity concept should be removed or retained, I believe there would be general agreement that there is need for significant improvement in relation to the reporting entity concept.

Peter: Many entities self classify as a non-reporting entity without truly considering the requirements. Many boards also do not understand the concept. What has become apparent is there's often inadequate disclosure in relation to the level of compliance with Australian Accounting Standards in the financial reports. The second element is therefor the transition or response to the weaknesses in the reporting entity concept.

Peter: In July 2019, the Australian Accounting Standards Board issued exposure draught ED 293, which will require additional disclosures in relation to compliance with the accounting standards, particularly in relation to measurement and recognition, assessing the impact of any future transition from special purpose financial reports to general purpose, who will be affected by the proposals, and what is proposed to be disclosed in special purpose financial reports.

Ram : Perhaps if we just move away a little bit from financial reporting, there happened to be many, many regulatory changes that continue to impact the not-for-profit sector. Could you perhaps provide some insights into some of these changes and what not-for-profits should be doing in preparing for these changes?

Peter: Sure. I think one of the significant areas is charities registered with the ACNC will be required to comply with new external conduct standards. It's expected that these external conduct standards will become effective from the 23rd of July 2019.

Peter: These external conduct standards include the following requirements, Standard One, activities and control of resources including funds. Standard two, annual review of overseas activities and record keeping. Standard Three, anti fraud and anti corruption requirements. And Standard Four, protection of vulnerable individuals.

Peter: It's critical that not-for-profits and their boards become familiar with the requirements of these new governance standards, particularly charities sending funds overseas. Another significant area to be aware of for charities is the outcome of the ACNC review that was tabled in parliament in August 2018.

Peter: The review included some 30 recommendations, including increasing the reporting thresholds for charities, removal of the basic religious charity concession. The recommendations include that certain large, not-for-profit entities be included under the regulation of the ACNC, and the requirement of all charities to disclose related party transactions. At this stage it is unclear what the government's response will be in relation to these recommendations.

Ram : We're certainly eagerly awaiting the response. Peter, before we wrap up, do you have any closing remarks?

Peter: Sure. I think we'll continue to see the not-for-profit sector facing continual changes. The AASB issued ED 291 in June 2019, which is considering not-for-profit entity definition and guidance. As we're aware, there are significant concessions for not-for-profit entities under the accounting standards, and this definition may change who is entitled to these concessions.

Peter: In summary, I think also that most entities will need to consider further board engagement, stakeholder communication, and make sure they have a plan in place to project manage the changes in relation to these requirements. I think it's also important to work cooperatively with your auditor and other advisors to ensure that you continue to achieve full compliance and enjoy the tax concessions that are afforded to charities.

Ram : Peter, thank you very much for your insights into what not-for-profits should be looking out for when getting ready for preparing the financial reports for the 30th of June 2019 year end. So thank you once again.

Peter: Good to be a part of it.

Ram : For listeners who might be interested in learning a bit more about some of the information provided in this podcast, please refer to the show notes on the webpage where this podcast is provided.

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