Annual Reports of Australian Not-for-Profit Organisations: Insights from Internal and External Stakeholders

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Introduction

This short report provides a high-level summary of the findings of a CPA Australia funded research project conducted by the Swinburne University of technology exploring the decision-usefulness of annual reports of Australian not-for-profit organisations. A more detailed report of the research findings is also available and can be accessed here.

Scope of the Research

The NFP sector is a highly diverse sector with varied legal structures, sizes, tax concessions, missions, activities and outputs/outcomes. We were interested in, among other things, obtaining an in-depth understanding of who the users of NFP annual reports (including the financial statements) are, users' information requirements, whether users' requirements are satisfied by the current reporting framework, preparers' understanding of reporting requirements, where any red tape challenges lie, the costs associated with NFP financial reporting, and NFP reporting other than through annual reports.

The research examined how:

- Australian Not-for-profit (NFP) organisations use the annual report, including the financial statements, to show they are accountable;
- the information in the annual report of NFP organisations, including the financial statements, is used by stakeholders to:
  - hold management and those charged with governance accountable in the discharge of their duties; assess management's,
  - and those charged with governance's, stewardship of the resources of the organisation;
  - and make other decisions.

Research Method

We conducted focus group discussions and interviews and collected data from participants. These participants held various roles within the sector, both internal and external to NFPs. Users, preparers, auditors, advisors, regulators, donors, board members, managers, accountants and member groups willingly gave their time to tell the stories of their NFP experiences, as well as their thoughts and suggestions for the future of reporting by organisations in this sector. Academics and journalists with interest in the area also joined the conversation and contributed their views as well. Many participants held multiple roles in the sector, working within NFPs in board-related or other roles for other NFPs. Some had paid positions, others were volunteers, and all were enthusiastic about contributing to this research.

Findings

The findings are as diverse as the participants and NFP organisations they represent and are reported under themes comprising: 1) The Annual Report; 2) Accountability; 3) Stakeholders; 4) Regulation and Reporting Thresholds; 5) Australian Accounting Standards; 6) Measuring Outcomes; 7) Evaluating Charities; 8) Risk; and 9) Audit.

The Annual Report

The diversity of perspectives makes summarising difficult. However, in general, most agreed that the financial statements within an annual report were an important means of providing accountability and transparency. Most agreed that accountability and transparency to stakeholders were important for a sector that relies heavily on donor or taxpayer funds, receives tax concessions and has diverse third-party stakeholders. Several felt that for a sector relying so heavily on volunteers, many with poor financial literacy, the level of regulation was excessive, and the reporting thresholds were too low and difficult to understand (in some instances, this includes the requirements of Australian Accounting Standards (AASs)). Most felt that imposing performance standards to measure outcomes or outputs was not viable. A minority however did express a view that the cost of producing annual reports outweighed the benefits in some instances, particularly for smaller NFPs.

Accountability

Despite participants holding varying (but usually complementary) views of what accountability represents, accountability has undoubtedly high importance in the NFP sector. Accountability is about being held responsible for the actions and operations of the organisation. Conceptually it is related to transparency and effectiveness, how effectively the organisation raised and utilised funds, and how it managed costs to achieve its objectives. Accountability was also intrinsically linked with stewardship; that is, responsibility for the resources entrusted to management to achieve the organisation's objectives. Ultimately accountability is how effectively and efficiently organisations conduct their activities, focusing on what they have done, how, and what they intend to do in the future and how.

NFPs' accountability was considered broader than for-profits, with primary accountability said to be owed to members, donors, and in some instances, God. Many participants believed the annual report to be the main document used to discharge an organisation's accountability, despite acknowledging many stakeholders are not interested in financial statements. From a practical standpoint, accountability was more likely discharged when stakeholders felt they knew what their organisation did and how they did it. The annual report communicated such information, as well as incorporating texts and photos to complete the picture.

Stakeholders

Stakeholders include members, management, regulators, donors/government, advisors, lawyers, professional accountants, auditors and the community at large. It seems very few stakeholders have any interest in the financial reports of an NFP, and engagement tends to be the result of an emotional connection with the said organisation rather than because of a financial report. Stakeholders not understanding the financial statements was seen as a barrier to maintaining good engagement, so the annual report tended to be more of a marketing exercise – with infographics and visual displays of key financial information being used to arouse engagement. When stakeholders are engaged, outcomes are far better, so successful organisations take every opportunity (including emails and social media podcasts) to engage with their stakeholders.

Regulation and Reporting Thresholds

Within the sector, several participants spoke of regulatory changes in progress such as:

- reviewing the Deductible Gift Recipient status of registered charities;
- the introduction of a national framework of legal structures and reporting thresholds for NFPs;
- AASB considering simplified reporting for certain NFPs;
- a change requiring charities, including not for profit service providers, to disclose where funds are coming from.

The current reporting threshold levels were said to be too low, with many suggesting they should be higher. Other suggested improvements included using rolling three-year averages based on revenue, moving from compulsory disclosure to voluntary disclosure, and factoring in public/private fundraising activities to the regulatory thresholds.

Australian Accounting Standards (AASs)

During discussions with participants about AASs, both positive and negative opinions were expressed about the required accounting for particular types of transactions and events. One school of thought was that the production of financial statements (with external assurance that these complied with financial reporting framework requirements) gave comfort the NFP was 'doing the right thing'. However, some participants saw regulations and standards as a burden in the form of red tape. Critically, many NFPs did not have the in-house technical knowledge necessary to prepare AAS financial statements, so they had to outsource the function. The Auditor and Advisor participants explained that, due to the NFP nature of the organisation involved, they often felt pressure to provide such services pro bono.

In terms of application, the following standards were singled out in discussions:

- AASB 9 (Financial Instruments) was cited as helping a board and management team's focus when making some important operational decisions;
- AASB 15 (Revenue from Contracts with Customers) was reportedly problematic for several charities. Along with AASB 1058 (Income of Not-for-Profit Entities), one represented NPF found it necessary to implement a different business practice with regards to revenue recognition;
- AASB 10 (Consolidated Financial Statements) was found to deliver a 'no consolidation' direction that did not align with user expectations of this sector.

Measuring Outcomes

The importance of differentiating outcomes from outputs and linking these to the mission drove much of the discussion in this area. The ability of NFP organisations to articulate outcomes, and the different approaches to measurement, especially in niche domains in which the NFP organisation operates, was notably challenging. This challenge was further compounded by having to track the level of activity in order to be able to report on outputs. Most participants felt that imposing performance standards to measure outcomes or outputs was not viable for these reasons.

It was clear that if performance outcomes were to be reported in the audited financial statements, this would pose a significant challenge to auditors, as "soft purpose" delivery statements are much more difficult to form an opinion on than hard numbers. Consequently, participants warned against mandating impact reporting.

Different views about the reporting of outputs, outcomes and impact lead to a discussion about the importance of the NFP telling the story about its mission (purpose), priorities and endeavours to meet the mission. While not everyone agreed, the storytelling approach was seen by many as inspirational and an important part of the 'marketing' strategy. The importance of social media platforms as a means to share stories and achievements was noted.

Evaluating Charities

Discussions about administrative costs and ratios naturally lead to questions about what percentage of a donation will go to overheads. For a number of reasons, the difficulty in making legitimate comparisons across different charities was apparent. A solution posed was to focus on projects (what the project aimed to do; what the outcome of that project was etc.), but participants confirmed that's easier for some projects than others. For example, a church may have been built (measurable), many hundreds of people may go to that church (measurable), but that does not tell you whether they are growing spiritually in their relationship with a belief or not (not measurable). You can easily measure activity, but it is not always easy to measure outcomes – some such things in the NFP domain are not measurable/quantifiable, despite being at the core of the mission.

Risk

There are many and varied risks within the sector - some manageable, others less so. Internal controls, perhaps unsurprisingly, drove risk to varying degrees – be it through a lack of segregation of incompatible duties or difficulties associated with safeguarding the completeness of cash donations. Resourcing pressures, and lower levels of financial accounting expertise compared with management accounting expertise, were also drivers of risk in NFPs. As such, leave liabilities and provision accounts were specifically highlighted by some NFPs as being large and potentially problematic.

The most critical risk for some NFPs to successfully manage, however, was the risk of not being able to continue their operations. Aside from the financial ramifications of such a risk being realised, a more significant, although perhaps less obvious one, came to the fore. Specific organisations might be the sole provider of niche services to vulnerable communities; if these NFPs fail, there are no other organisations 'at the ready' to fill the void.

While various interested parties, as well as conservative approaches, played their part in mitigating risks, audits and auditors were almost uniformly seen as the 'answer' to managing risks within NFPs. Several participants pointed to the risks involved with the sector, especially in-service provision for vulnerable communities where no alternative existed.

Audit

Auditors and audits were almost universally relied on to enhance accountability and transparency. The audit and auditors' roles, including the need to maintain audit independence, were commonly cited as being misunderstood – as evidenced by Auditors revealing that requests for financial reporting support were increasingly commonplace. Audits of NFPs were said to be difficult and risky. To mitigate the risk to the auditor, it is not uncommon nowadays for auditors to assist by preparing the financial report themselves – albeit based on the information given to them by the NFP.

Auditors further revealed they were often expected to act in an honorary capacity and felt that, given the risks in the sector, and increases in professional indemnity insurance costs, this situation was not tenable in the longer term.

Conclusion

The findings reveal diverse views that are difficult to summarise. The sector is clearly undergoing changes in regulation that are not universally welcomed by stakeholders. However, there is consensus about the importance of annual reporting (including the financial statements) as an accountability mechanism. The fact that the sector receives taxpayer funds, whether directly or indirectly through deductible gift recipient status, is generally accepted to create a moral obligation for transparency and storytelling about organisations' missions and performance against their missions. There was little enthusiasm for requirements for performance measurement, however.

In terms of AASs and the threshold for general purpose financial reporting, the feeling was that the current reporting trigger needed to be increased. Several participants noted the differential treatment of charities compared with other NFPs and some anomalies this created. The heavy reliance on audits and auditors by many in the sector, especially users of financial reports who are not always financially literate, preparers who sometimes are volunteers and ill-equipped for the task, and boards struggling to keep up with changing AASs emerged. However, auditors were under pressure to minimise costs and some misunderstanding of what it is that auditors take responsibility for when providing an opinion on financial statements also emerged. There was also evidence from regulators that not all auditors working in the sector understand the regulations or frameworks under which they report. The pandemic is likely to have exacerbated stresses in the sector, and reliance on volunteers and honorary auditors by some in the sector is not sustainable.