

# KEY THEMES

## ROUNDTABLE

### NOT-FOR-PROFIT FINANCIAL REPORTS AND THE REPORTING ENTITY CONCEPT – WHERE TO NOW FOR FINANCIAL REPORTING?

#### INTRODUCTION

In November 2014, CPA Australia hosted a half-day roundtable to explore financial reporting by not-for-profit (NFP) entities and the implications of applying the reporting entity concept and Australian Accounting Standards (AAS) issued by the Australian Accounting Standards Board (AASB). This roundtable and a similar roundtable organised for the for-profit sector along with other activities will inform CPA Australia's policies and initiatives in response to the findings published by the AASB from their research project<sup>1</sup> into the application of the reporting entity concept. The AASB research project has raised questions over whether the reporting entity concept is being correctly applied by those entities that prepare financial reports in accordance with AAS.

Participants at the roundtable included NFP entity representatives, Commonwealth and state regulators, standard setters, auditors and advisers. Participants discussed NFP financial reporting issues arising from the AASB research findings, and explored other matters including the scope and breadth of financial reporting by NFPs across Australia, and the information needs of NFP stakeholders.

The NFP sector is comprised of approximately 700,000 entities that make a significant economic and social contribution in Australia. A diverse range of entities populate the sector, whose financial reporting is determined by factors such as an NFP's size, activity, location and legal form. Many of these entities prepare financial reports for a number of reasons including legal or regulatory requirements and contractual obligations arising from funding arrangements.

Discussions held at the roundtable revolved around the AASB research findings and their implications for NFP financial reporting, considerations for policy-makers and law-makers, and other related issues relevant to reporting of valuable information (financial or otherwise) by NFPs.

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<sup>1</sup> [http://www.aasb.gov.au/admin/file/content102/c3/AASB\\_RR-1\\_06-14\\_Reporting\\_Entities\\_and\\_SPFSs.pdf](http://www.aasb.gov.au/admin/file/content102/c3/AASB_RR-1_06-14_Reporting_Entities_and_SPFSs.pdf)

A number of key themes arose from the discussions that are discussed below. These insights will assist CPA Australia further develop its policy positions and assist with progressing the debate on the form, content and scope of reporting by Australian NFPs more broadly.

## **KEY THEME 1 – THE VALUE OF FINANCIAL REPORTING**

The AASB research project, in arriving at its conclusions, considered financial reports lodged with regulators. However, no substantive work was undertaken by the AASB to understand what the information needs of users of NFP financial reports are and whether the financial reports currently being prepared meet those needs. In determining policy direction it would be important for standard-setters, lawmakers, regulators and other stakeholders to understand what users of NFP financial reports consider good quality financial reporting that satisfies their needs. One argument for requiring NFPs to prepare financial reports based on AAS is supported by the fact that many NFPs are having to adopt an increasingly commercial outlook in the current economic environment, both to obtain and retain funding. However, there are indications that the financial reporting requirements for NFPs in Australia are excessive compared to similar requirements in other comparable jurisdictions.

A range of statutory (Commonwealth and State/Territory) and other financial reporting requirements exist within the NFP sector, ranging from requirements to prepare financial reports applying the full AAS (or the AAS Reduced Disclosure Requirements (RDR)) framework (e.g. large ACNC registered charities and large companies limited by guarantee), to those that allow simple cash-based financial information to be prepared and lodged (e.g. small ACNC registered charities and some incorporated associations in South Australia and Victoria). Whilst the AASB research project focused on the application of the reporting entity concept, there are statutory requirements within the NFP sector, which do not require application of AAS in the preparation of financial reports and consequently the application of the reporting concept is also not required.

In addition to identifying a need to explore the information needs of users in establishing suitable reporting frameworks, participants at the roundtable also highlighted a lack of consistency in financial reporting requirements as detrimental to the overall quality of financial reporting by NFPs. Whilst there is some justification for demarcating financial reporting requirements based on entity size, and in some cases based on entity activity (e.g. fundraising), a consistent reporting framework applicable to financial reports prepared by NFPs would be beneficial. However, practical challenges remain, including differences in legislative cycles operated by different jurisdictions and the political and economic agendas driving the various Commonwealth and State/Territory regulators and law-makers.

## **KEY THEME 2 – FINANCIAL REPORTING AS A COMPLIANCE EXERCISE**

The objectives of financial statements are to provide information to users in making economic decisions, and to show the results of the stewardship of management, or the accountability of management for the resources entrusted to it. The range of Commonwealth and State/Territory statutory requirements that require financial reports result in a significant volume of financial reports being prepared and lodged with various regulators and agencies. Whilst the form and content required for financial statements may vary, the basic requirement to prepare and lodge financial statements forces a substantial volume of NFPs, from the smallest to the largest, to prepare and lodge financial reports. There is a concern that not all statutory financial reporting requirements and the resulting financial reports prepared meet the intended objectives of financial statements.

The early adoption of AAS RDR by those NFPs that qualify to adopt it suggests that many of these entities previously experienced a financial reporting burden that was eased to some extent by the AAS RDR framework.

General Purpose Financial Statements (GPFS) may be prepared because funding providers require it or because the requirement is set out in the constitutional or governing document of the NFP entity. Such requirements may be set without consideration as to whether the entity the requirement applies to is a reporting entity or not. There is a suggestion that there may not necessarily be an awareness of the reporting entity concept by those who set financial reporting requirements. A further issue identified was that not all NFP stakeholder groups receiving GPFS either require or are able to understand and appreciate the financial information provided in GPFS.

Grant acquittals and other reporting obligations arising from funding arrangements are seen as causing a significant amount of red tape for NFPs. The costs of preparing the necessary information and obtaining an audit can also drain the financial and other resources of an NFP, eroding its ability to apply such resources in achieving its primary objectives.

Transparency remains a critical requirement for NFP operations, as many of these entities rely on public benevolence (through tax concessions and government funding) and private philanthropy. Regulators and government agencies need to consider whether the financial reporting requirements result in transparency that allows them and other stakeholders to assess whether the funds provided to an NFP have been applied as intended by the funding provider(s). However, in setting financial reporting requirements to aid transparency, regulators need to strike the right balance between transparency through financial reporting that benefits the sector and its stakeholders and excessive financial reporting requirements that increase regulatory burden that exceeds the benefits derived.

### **KEY THEME 3 – THE ROLE OF AUDITORS AND ACCOUNTING PROFESSIONALS**

Members of the three main professional accounting bodies in Australia involved in the preparation or assurance (audit/review) of financial statements are required to consider the implications of the reporting entity concept as a result of obligations arising from the Accounting Professional and Ethical Standards they are required to follow. These obligations exist regardless of whether the statutory or other requirements impose the application of AAS in the preparation of financial statements.

Auditors and professional advisers have significant involvement in the assessment of whether an entity is a reporting entity or not. Often auditors having made their own determination, concur with the audit client's determination of whether or not the entity is a reporting entity, and document within the audit file, their discussions and other work done as part of this determination.

### **KEY THEME 4 – USER NEEDS FOR INFORMATION**

As stated under Key Theme 1, it is important to understand the specific needs of users of financial information produced by NFPs. The information needs of such users may not be restricted to financial information as they may seek and need other types of information from an NFP entity. Examples of such information could include how an NFP has performed during a reporting period against its stated objectives and the application of funds received and the benefits arising from such application.

It is important to identify what the reporting outcomes are for the NFP sector, including who the stakeholders are, what their information needs are, and whether these needs are being met by the current applicable frameworks of financial reporting. If there is an identified need to develop different reporting frameworks, or to modify the existing reporting frameworks, it is necessary to identify who should be charged with the responsibility of developing the necessary frameworks for reporting.

The directors' report is an important source of information outside the financial statements, providing a management view of strategy and direction of the organisation. Different statutory requirements may be similar (e.g. management committee report for an incorporated association), however, drawing from the Corporations Act requirements on the content of a directors' report and applying it to other NFPs would

be a useful step forward, allowing NFP boards to demonstrate entity performance compared to its objectives, key performance indicators and risks and other relevant factors.

Other types of reports that may provide valuable information include Social Return on Investment reports and Service Performance reports. In some cases, larger NFPs are required to provide such information to continue to receive funding from different agencies as part of their contractual arrangements. These types of reports could be considered as an addition to, or in some cases as an alternative to the current financial based grant acquittals that many NFPs have to provide as part of their funding arrangements.

## THE WAY AHEAD

Evidence suggests that whilst there are attributes to user information needs common across the sector, user information needs can also differ based on entity specific characteristics like size, legal form and type of activity the entity undertakes. It is possible that one single reporting solution may not entirely satisfy the diverse range of user information needs, but achieving consolidation and consistency of reporting frameworks to some extent is still desirable. To do so, it is necessary to get a better understanding of what users consider the most valuable information NFPs should prepare and provide to them.

For accountability and transparency reasons that are unique to the NFP sector, there may still be justification for many NFPs to prepare financial information, however the need to lodge such information with various regulators needs to be considered. Also, relieving some of the smaller NFPs from financial reporting entirely should also be considered on the basis of a cost-benefit analysis and regulatory impact assessment.

The AASB has indicated that it is likely to focus on standard-setting for the preparation of GPFS. If law-makers and regulators are of the view that NFPs who are not reporting entities do not have to prepare GPFS but are still required to prepare financial reports, consideration has to be given to what financial reporting framework is suitable for such entities.

Alternative forms of reporting to financial reporting should also be given consideration as a possible solution or as information complimenting financial information provided by NFPs. Such alternative forms of information may prove useful in providing better quality information in satisfying reporting for grant acquittals and other funding provider needs.

CPA Australia will consolidate the findings from this roundtable with findings from the second roundtable held in November considering the impact of the reporting entity concept on for-profit entities. The current intention is to develop a discussion paper that sets out the key themes emerging from the two roundtables for further discussion and feedback with a wider group of stakeholders. We believe these policy initiatives will assist CPA Australia, the AASB and a number of Commonwealth and State/Territory law-makers in determining appropriate reporting frameworks that effectively meet stakeholder needs whilst reducing excessive regulatory burden arising from unnecessary financial reporting requirements.