Requirements for annual financial reports under the ACNC framework

1. Background

The Australian Charities and Not-for-profits Commission Act 2012 (ACNC Act) implements a new reporting framework for entities registered with the Australian Charities and Not-for-profits Commission (ACNC).

In order to minimise the compliance burden on registered entities, reporting requirements under the Act are proportional to the size of registered entities, based on a revenue threshold. There are three tiers for small, medium and large registered entities.

- A small registered entity is an entity with annual revenue of less than $250,000.
- A medium registered entity is an entity with annual revenue of $250,000 or more and less than $1 million.
- A large registered entity is an entity with annual revenue of $1 million or more.

These revenue thresholds are consistent with existing thresholds that apply to companies limited by guarantee, and is also in line with thresholds for incorporated associations recently introduced in Victoria.

The Commissioner may allow an entity not to transition from one tier to another tier if the transition is caused by something extraordinary and the registered entity would likely transition back to the original tier the follow year.

Only medium and large registered entities will be required to provide annual financial reports to the ACNC. However, the requirement to prepare a financial report is not mandatory for a basic religious charity.

Large registered entities will be required to have their financial reports audited, and medium registered entities can generally choose to either have their financial reports reviewed or audited.

In May 2012, the Government announced that the detailed reporting requirements, and the governance and external conduct standards, would commence from 1 July 2013 and would be implemented by regulation, to enable further consultation on these requirements.

Registered entities will be required to prepare their first reports for the 2013-14 financial year. As a result, the first financial report will need to be lodged with the ACNC by 31 December 2014, or within six months after the end of an approved substituted accounting period that commences after 1 July 2013.

Unlike annual financial reports which are only mandatory for medium and large registered entities, all registered entities will be required to prepare an annual information statement. The extent of information required in the annual information statement will also be proportional to the size of the entity. The first annual information statement will be in respect of the 2012-13 financial year. As a result, the first annual information statement will need to be lodged with the ACNC by 31 December 2013, or within six months after the end of an approved substituted accounting period that commences after 1 July 2012. As a transitional arrangement, the Commissioner is not seeking financial information in the first annual information statement but will begin to do so for all registered entities from the 2013-14 financial year.

2. What are the requirements for annual financial reports?

Small registered entities, which will constitute the vast majority of entities registered with the ACNC, will not be required to prepare an annual financial report. Based on Australian Taxation Office data, currently 78 per cent of entities registered with the ACNC will fall into the small tier, 11 per cent in the medium tier, and 11 per cent in the large tier.

Medium and large registered entities will be required to prepare and lodge with the ACNC an annual financial report. The first annual financial reports will not be due until 31 December 2014, or six months after the end of an approved substituted accounting period that commences after 1 July 2013.

The annual financial report consists of the following three elements:

- the financial statements for the year;
- the notes to the financial statements; and
- the declaration made by the responsible entities about the financial statements and the notes.

The financial statements and notes will, in most cases, need to comply with accounting standards issued by the Australian Accounting Standards Board (AASB). There are some exceptions to the requirement to apply accounting standards, which are discussed below.

The notes must contain any other information necessary to give a true and fair view of the financial position and performance of the registered entity.

3. What does complying with accounting standards mean?

In most cases, the reports prepared by medium and large registered entities will need to comply with accounting standards (except in certain circumstances which are explained further below).

a) General purpose and special purpose financial reports

Compliance with the accounting standards does not necessarily mean that an entity will need to apply the full suite of accounting standards in preparing their report. This will depend on whether or not the entity is considered to be a 'reporting entity'.

A 'reporting entity' must prepare a general purpose financial report (GPFR), which applies the full suite of accounting standards, or they can choose to adopt the Reduced Disclosure Requirements regime (which is further discussed below).

A ‘non-reporting entity’ generally prepares a special purpose financial report (SPFR) to meet the needs of specific users but can choose to prepare a GPFR if it wishes. Currently, in relation to the *Corporations Act 2001* (Corporations Act) framework, the application paragraphs of most accounting standards state that they apply to reporting entities lodging reports under Part 2M.3 of the Corporations Act, with the exception of five standards. The application paragraphs of these five standards state that they apply to all entities lodging reports under Part 2M.3, irrespective of whether they are reporting or non-reporting entities. These standards are AASB 101 *Presentation of Financial Statements*, AASB 107 *Statement of Cash Flows*, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, AASB 1031 *Materiality* and AASB 1048 *Interpretation of Standards.*

The AASB (as standard-setter) and the ACNC (as regulator) will work together to develop guidance on financial reporting for entities registered with the ACNC, including reporting requirements of non-reporting entities registered with the ACNC. However non-reporting entities registered with the ACNC would only be expected to apply these five key accounting standards, rather than full suite of accounting standards. These five standards are currently seen as necessary for any financial reports to give a true and fair view as required by the financial reporting regulations.

In the Corporations Act context, ASIC has issued Regulatory Guide 85 “*Reporting requirements for non-reporting entities*”, which states that non-reporting entities lodging reports are required to comply with the recognition and measurement requirements of all accounting standards, and those disclosure requirements necessary to give a true and fair view. This regulatory guide applies only in respect of reports lodged under Part 2M.3 of the Corporations Act, and does not apply to reports that are required to be lodged under the ACNC Act.

b) Do I need to prepare a general purpose or special purpose financial report?

The test for whether an entity is a ‘reporting entity’ or not is set out in the accounting standards as follows (see Appendix A of AASB 1053 *Application of Tiers of Australian Accounting Standards)*:

> *‘an entity in respect of which it is reasonable to expect the existence of users who rely on the entity’s general purpose financial statements for information that will be useful to them for making and evaluating decisions about the allocation of resources. A reporting entity can be a single entity or a group comprising a parent and all of its subsidiaries.’*[1]

If a registered entity does not meet this test, it can prepare a SPFR rather than a GPFR.

A registered entity’s responsible entity or entities decide on the type of financial report that needs to be prepared applying this test. The responsible entity’s determination as to whether the entity should be classified as a reporting entity or a non-reporting entity is an important decision affecting the level of disclosure in the financial report. This decision needs to be made in view of the requirement for the responsible entity to make a declaration about compliance with accounting standards (discussed further below).

[1] Reporting under the ACNC framework is at the registered entity level, unless joint or collective reporting requirements apply.

The auditor or reviewer of the registered entity will also need to make a decision about the appropriateness of the classification of an entity as a non-reporting entity in forming an opinion as to whether the entity's financial report complies with accounting standards.

The reporting entity test is focused on whether there exist users who cannot directly obtain the information they require. It excludes entities with only users who can directly obtain the information they need, such as some closely-held private businesses.

Statement of Accounting Concepts SAC 1 "*Definition of the Reporting Entity*" outlines relevant factors, which are set out below. These factors are indicative, not determinative, and the particular circumstances of an entity will need to be considered in determining whether it is a reporting entity:

- *Identification of Whether Dependent Users Exist*

  In many instances, it will be readily apparent whether, in relation to an entity, there exist users who are dependent on general purpose financial reports as a basis for making and evaluating resource allocation decisions. Where it is not readily apparent whether such dependent users exist, the primary factors to be considered in determining whether a registered entity is a reporting entity is set out below.

- *Separation of management from economic interest*

  The greater the separation between ownership (including members or others with an economic interest in the entity) and management, the more likely it is that there will exist users dependent on general purpose financial reports as a basis for making and evaluating resource allocation decisions.

- *Economic or political importance/influence*

  Economic or political importance/influence refers to the ability of an entity to make a significant impact on the welfare of external parties. The greater the economic or political importance of an entity, the more likely it is that there will exist users dependent on general purpose financial reports as a basis for making and evaluating resource allocation decisions. Reporting entities identified on the basis of this factor are likely to include organisations which enjoy dominant positions in particular sectors of the economy and those which are concerned with balancing the interests of significant groups, for example, employer/employee associations.

- *Financial characteristics*

  Financial characteristics that should be considered include the size (for example, value of assets, or number of employees) or indebtedness of an entity. In the case of not-for-profit (NFP) entities in particular, the amount of resources provided or allocated by governments or other parties to the activities conducted by the entities should be considered. The greater the indebtedness or resources allocated, the more likely it is that there will exist users dependent on general purpose financial reports as a basis for making and evaluating resource allocation decisions.

Example 1: Entity that is likely to be a reporting entity

XYZ Company is a well-known charitable public company limited by guarantee. It has an annual revenue of $15 million, and a large membership base, comprising of 900,000 members. It has around 300 employees, 60 creditors, and 15 directors. XYZ also raises funds from the public by issuing debentures.

XYZ is a reporting entity because it has issued debentures, and as such, there will be potential debenture holders who require GPFRs as a basis for making decisions about the allocation of resources. There are also a number of other factors that suggest it is a reporting entity, for example, the fact that it is a well-known company, which has a significant number of members, employees and creditors. This suggests that there may be users dependent on GPFRs as a basis for allocating resources. In this scenario, there is also a significant separation between ownership (500,000 members) and control (15 directors), which again suggests that there may be users, including current and potential members, dependent on GPFRs as a basis for allocating resources.

Example 2: Entity that is not likely to be a reporting entity

ABC is a charity, which is registered as an incorporated association under State legislation. It has an annual revenue of $255,000, and a relatively small membership base, comprising of ten members, all of whom are on the association's committee of management. ABC obtained a loan from its local bank, however, the bank has the ability to obtain financial information from ABC, that is tailored specifically to meet the bank's needs.

Based on these assumed facts alone, ABC is unlikely to be a reporting entity. Under this scenario, there is no separation of ownership from control, as all of the association's members are on the committee of management. ABC also has minimal borrowings, creditors and employees, which reduces the likelihood that there will be users dependent on GPFRs to make decisions about the allocation of resources. ABC's lender, the local bank, is able to command the preparation of financial information tailored to its own needs, and therefore, does not need to rely on GPFRs.

c) Reporting entity statistics

Based on sample ASIC data,[2] nearly half of companies limited by guarantee currently reporting under the Corporations Act in the medium tier report as non-reporting entities, and nearly one third of companies in the large tier report as non-reporting entities.

	Reporting	**Non-reporting**
Medium	53 per cent	47 per cent
Large	68 per cent	32 per cent

[2] Based on a random sample of 50 financial reports of companies limited by guarantee registered under the *Corporations Act 2001*.

It is important to note that this sample data may not necessarily be representative of the proportion of reporting and non-reporting entities across the entire NFP sector. The data relates to companies limited by guarantee registered under the Corporations Act. These companies generally represent larger organisations that may satisfy more of the indicators for general purpose financial reporting, compared to other structures, such as a small unincorporated association.

The thresholds contained in the Corporations Act for companies limited by guarantee include consideration of deductible gift recipient status, in addition to revenue thresholds, whereas the ACNC thresholds are based solely on revenue thresholds. While this is not a perfect comparison, it does provide a general indication of the proportion of entities preparing SPFRs and GPFRs for companies limited by guarantee.

d) Real life examples of entities that classify themselves as reporting entities and non-reporting entities

	Reporting	**Non-reporting**
Medium	The Shorthorn Society of Australia Ltd Diversity Council Australia Limited The Concrete Masonry Association of Australia Limited Dymocks Children's Charities Limited Coonamble & District RST Club Ltd Kids of Macarthur Health Foundation Ltd Port Stephens Community Care Limited Woollahra sailing Club Ltd National Children's and Youth Law Centre	National Association of Women in Construction; Australian Independent Record Labels Association Ltd; National Association of Women in Construction; Australian Independent Record Labels Association Ltd; North Melbourne Giants Basketball Club Ltd; Mission Enterprises Blackburn Limited; Bicycle Industries Australia Ltd; Life Centre International Limited; The Church of Pentecost Australia Limited; Bereavement Assistance Limited.
Large	The Hunger Project Australia The Asthma Foundation of Queensland Highlands Golf Club Ltd	Our Lady of Sion College Ltd; Lifeline Darling Downs and South West Queensland Limited;

	Reporting	Non-reporting
	Charingfield Limited Doxa Youth Foundation Karuah & District RSL Club Ltd Woollahra Golf Club Ltd Steven Walter Children's Cancer Foundation Dairy Innovation Australia Limited Medi-aid Centre Foundation Ltd Public Transport Ombudsman Limited The Croatian Club Ltd Central Coast Emergency Accommodation Services Ltd	Montessori School Limited; The Eltham College Foundation Limited; The Olympic Winter Institute of Australia Limited; The Gregory Terrace Foundation.

e) Will I have to prepare a GPFR if the report is being made publicly available on the ACNC register?

No, the disclosure of the report on a public register, such as the ACNC information portal, does not necessarily mean that the report needs to be a GPFR. Often, the reports on other public registers, such as ASIC's public registers, are special purpose financial reports.

Whether the reporting entity test is satisfied depends on the extent to which there are external users of the reports who are unable to command tailored information, not by whether those reports are publicly available.

Based on sample ASIC data, around 47 per cent of medium companies limited by guarantee prepare special purpose financial reports notwithstanding that the report is placed on ASIC's public register.

f) Reduced Disclosure Requirements (RDR) for GPFRs

Those registered entities that are required to prepare GPFRs have the option of applying a significantly less onerous disclosure regime, known as the 'reduced disclosure requirements' (RDR) regime, compared to the full disclosure requirements of the accounting standards.

These requirements have been developed by the AASB, and apply to reporting periods beginning on or after 1 July 2013, but can be adopted earlier.

Entities that choose to apply RDR will be subject to the same recognition and measurement requirements as entities reporting under the full set of accounting standards, but will have considerably fewer disclosures in the notes to their financial statements.

This will significantly reduce the disclosure burden, and the reporting and auditing/reviewing costs for registered entities that are required to prepare a GPFR.

Further information about RDR is contained in accounting standard AASB 1053 *Application of Tiers of Australian Accounting Standards.*

The financial statements and the notes

The financial statements are those statements required by the accounting standards. The financial statements comprise:

- a statement of financial position;
- a statement of profit and loss and other comprehensive income for the period;
- a statement of changes in equity for the period;
- a statement of cash flows for the period; and
- notes, comprising a summary of significant accounting policies and other explanatory information.

True and fair view

The regulations provide that the annual financial statements and notes must give a true and fair view of the financial position and performance of an entity.

However, this does not affect the obligation under the regulations to comply with accounting standards. If the financial statements and notes prepared in accordance with accounting standards would not give a true and fair view, the regulations require that additional information must be included in the notes to the financial statements.

The regulations provide that the notes to the financial statements are:

- the disclosures required by the accounting standards; and
- any other information necessary to give a true and fair view.

While there is no agreement or authoritative judicial pronouncement on the meaning of the expression 'true and fair view', in nearly all cases, compliance with accounting standards is likely to lead to a true and fair view. As accounting standards are continuously improved and modernised, there is less scope for the operation of the additional 'true and fair view' requirement.

As a result, in nearly all cases, the ‘true and fair’ disclosure requirement is not expected to be triggered, and compliance with accounting standards is sufficient to give a true and fair view.

Responsible entities’ declaration

The regulations require the responsible entities to provide a declaration that states:

- whether, in their opinion, there are reasonable grounds to believe that the registered entity is able to pay all of its debts, as and when they become due and payable; and
- whether, in their opinion, the financial statements and notes satisfy the requirements of the Act.

The declaration must be signed by a responsible entity that is authorised to do so by the responsible entities.

This declaration forms part of the financial report that will need to be lodged with the ACNC for financial years commencing 1 July 2013 or equivalent approved substituted accounting period.

What are the exceptions to applying accounting standards?

Joint and collective reporting

Under the new framework, the ACNC Commissioner may approve new types of reporting, referred to as 'joint' and 'collective' reporting, which will enable entities to report as charitable groups (joint reporting) or along certain lines of activity, rather than on an entity-by-entity basis (collective reporting). There are a number of factors the Commissioner must consider before deciding whether to allow a particular group of entities to report in this way. These factors are listed in subsection 60-95(4) of the ACNC Act. As approval for collective and joint reporting is applied prospectively, registered entities will need to plan well in advance if they wish to adopt these reporting arrangements for a future financial year.

Depending on the circumstances, joint and collective reporting may diverge from particular accounting standards, such as accounting standard AASB 10 *Consolidated Financial Statements*. In such cases, the regulations provide that NFP entities will still be required to apply all relevant accounting standards, except for those which are inconsistent with this type of reporting.

In allowing joint and collective reporting under the ACNC Act, the Commissioner may specify conditions relating to the information or reports, including particular accounting standards that do not need to be complied with or need to be adhered to with certain modifications.

Additional reporting requirements where ACNC Commissioner requires

The ACNC Commissioner also has the authority to require entities to provide additional information, and to lodge additional reports. This type of additional reporting would only be used where necessary, for example, where there is reason to believe that an entity has contravened the ACNC Act.

Depending on the circumstances, the additional report of information sought by the Commissioner may diverge from particular accounting standards. In such cases, the regulations provide that NFP entities will still be required to apply all relevant accounting standards, except for those which are inconsistent with the Commissioner's determination.

In requiring further information under the ACNC Act, the Commissioner may specify requirements relating to the information or reports, including particular accounting standards that do not need to be complied with or need to be adhered to with certain modifications.

Comparative year reporting

As noted above, the financial reporting framework will apply to financial years commencing 1 July 2013, or the equivalent substituted accounting period.

As a transitional arrangement, entities will not be required to disclose comparative year information in the first year. The regulations provide that the relevant requirements relating to comparative year reporting, contained in the paragraphs 38 to 44 of accounting standard AASB 101 do not apply in the 2013-14 financial year or the corresponding approved substituted accounting period.

This will ensure that entities do not need to apply the accounting standards to periods prior to 1 July 2013.

Reports given to other Australian government agencies

Under the new regime, the Commissioner may allow reports given under an Australian law to an Australian government agency (which includes both Commonwealth and State agencies) as being a financial report under the ACNC Act up and until the 2014-15 financial year (or later year prescribed by regulation).

This will enable the ACNC Commissioner to address potential reporting duplication during the process of establishing the ACNC as a 'one-stop shop' regulator.

The reports provided to another Australian government agency need not necessarily comply with accounting standards, but the Commissioner may allow such reports to satisfy the reporting requirements under the ACNC framework, as a transitional measure.

There are a number of factors the Commissioner must consider before deciding whether to allow these reports to satisfy ACNC reporting requirements. This includes consideration of the following matters:

- what access the Commissioner has to the statement, report or other document;
- whether the statement, report or other document contains:
  - the information required under the ACNC Act to be in the information statement or reports; or
  - other information that relates to, or has the purpose of, enabling the same recognised assessment activities to be carried out in relation to registered entities;
- the processes that have been undertaken to verify the information contained in the statement, report or other document. This may include, for example, whether the report, statement or document has been subject to an audit or review.

However, in the case of non-government schools, the Commissioner must accept reports lodged under section 24 of the *Schools Assistance Act 2008*, as meeting the ACNC's requirements for annual financial report for a transitional period and does not need to consider the matters listed above. This transitional arrangement will apply until the 2014-15 financial year, or a later year prescribed by the regulations. This will ensure that non-government schools will not be subject to reporting duplication during the process of establishing the ACNC.

Who can conduct a review of a medium registered entity?

As noted above, medium registered entities can generally choose to have their reports reviewed rather than audited.

A review, in contrast to an audit, is not designed to provide reasonable assurance that the financial report is free from material misstatement. A review may bring significant matters affecting the financial information to the reviewer's attention, but it does not provide all of the evidence that would be required in an audit.

An audit must be undertaken by a 'registered company auditor' (RCA), an audit firm or an authorised audit company.

However, reviews can be performed by a wider class of individuals. In addition to RCAs, audit firms and authorised audit companies, a member of a professional accounting body can conduct a review, provided they hold the relevant designation of that professional body, as prescribed by the regulations.

The draft regulations prescribe these designations, which represent the relevant designations for members of the Institute of Chartered Accountants in Australia (ICAA), Certified Practising Accountants Australia (CPAA), and the Institute of Public Accountants (IPA). The requirement to hold the specified designations excludes members of the professional accounting bodies who have not yet completed the relevant CPA/CA/IPA program.

This allows a broad class of individuals to undertake reviews, with some limitations to ensure that reviewers are subject to appropriate professional standards.

In practice, this means that a reviewer must be a member of a professional accounting body, who is not a student member, and who is subject to certain minimum standards, such as continuous professional development, in line with the requirements of the professional accounting bodies.

The professional accounting bodies impose their own internal rules concerning the obligations on individuals undertaking audits and reviews, with a view to maintaining high standards and quality services provided by individuals who hold themselves out as having that organisation's designation.

For example, in respect of pro-bono work, CPAA does not require a person to hold a practising certificate, but they are required to:

- have CPA/FCPA designation;
- hold appropriate professional indemnity insurance, which is reviewed annually (except in certain volunteer situations);
- undertake 120 hours of continuing professional developments every three years, with a minimum of 20 hours per year;
- adhere to professional standards, including APES 110, which requires an auditor to use their professional judgment to assess threats to their independence; and
- comply with any other regulatory and legal requirements, as well as CPAA's internal rules and regulations.