



## Australian Government

### Australian Accounting Standards Board

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Dear Manager

#### **Exposure Draft: Requirements for annual financial reports under the ACNC framework, accompanying ACNC Regulation 2012**

Thank you for providing the opportunity to comment on the Exposure Draft. The following reflects the views of AASB members and generally focuses on matters related to the proposals for annual financial statements and notes to be prepared by medium and large registered entities.

We note the proposed model is based on the existing reporting entity model adopted in AASB Standards (and through those Standards under the Corporations law). However, the AASB is currently conducting research that may lead the AASB to reconsider the use of that reporting entity model. An outcome of this work could be that AASB Standards would only specify requirements for entities that lodge or otherwise make available general purpose financial statements. Therefore, although a regulator might choose to continue to use the reporting entity concept for purposes of specifying requirements, the AASB Standards might not.

Considered from an historical perspective, the reporting entity model and the related practice of special purpose financial reporting evolved in an environment prior to the incorporation of International Financial Reporting Standards (IFRS) and prior to the development of Reduced Disclosure Requirements (RDR) by the AASB for general purpose financial reporting. The application of IFRS is not based on a reporting entity model and RDR reporting is now available to all private sector not-for-profit entities, subject to their regulator's requirements. RDR reporting was developed in response to concerns about the onerous nature of the full disclosure requirements of AASB Standards relative to the reporting needs of users of financial information of some types of entities. The AASB regards its role as providing requirements that can be used by regulators in regulating the general purpose financial reporting of the entities they regulate. Requirements for special purpose financial reporting might best be designed by the regulators themselves to suit the entities they regulate based on regulators' detailed knowledge of the particular users and their needs in respect of the entities they regulate.

Within the context of the above comments, whilst we are heartened by the broad proposal to adopt the AASB Standards, we have significant concerns that the proposals:

- (a) include (potentially significant) exceptions to those Standards, and therefore the resulting financial statements would not meet the needs of users of general purpose financial statements; and
- (b) contemplate the creation of AASB Standards for non-reporting entities/special purpose financial statements.

In the following, we expand on these concerns, before raising other matters for your consideration in progressing the proposals.

### ***Meeting the needs of users of general purpose financial statements***

On page 2, the Explanatory Material states that “The financial statements and notes will, **in most cases**, need to comply with accounting standards issued by the … (AASB)” (emphasis added). We do not have a sense of how pervasive the exceptions to mandatory compliance (eg, the exceptions relating to joint and collective reporting – which, as we understand them, would not generally comply with AASB Standards) would be, and therefore are not in a position to comment on whether compliance with accounting standards would occur ‘in most cases’.

Furthermore, we are unclear on the implications of footnote 1 on page 3 of the Explanatory Material, which states that “Reporting under the ACNC framework is at the registered entity level, unless joint or collective reporting requirements apply”, particularly in the light of page 10 of the Explanatory Material, which contemplates joint reporting not being in compliance with AASB Standards. In particular, it is stated on page 10 that: “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.” We understand the footnote means that where one registered entity (parent) controls another entity (subsidiary – whether it is a registered entity or not), the former would not be permitted to consolidate the latter) unless permitted to do so as joint reporting by the Commissioner. If our understanding is correct, we would anticipate that potentially a significant number of registered entities would not comply with AASB Standards, as consolidation of controlled entities is a fundamental principle in those Standards.

The objective of general purpose financial statements prepared in accordance with AASB Standards is to provide information useful to users for making and evaluating decisions about the allocation of scarce resources. Such reports assist entities in discharging their accountability. Accordingly, given the proposed exceptions to compliance with AASB Standards, we question whether the proposals would be sufficient to meet the needs of users – potentially including the ACNC itself. To address our concern, we think further consideration should be given to explicitly requiring a registrant that the ACNC requires to prepare general purpose financial statements to prepare consolidated financial statements in accordance with AASB Standards, perhaps in addition to separate financial statements. Consolidated financial statements would provide better information about a registrant for users, by recognising all of the assets, liabilities, income and expenses controlled by the registrant. This is because the process of consolidation looks through the legal structure of a registrant to the underlying economics.

If a registrant's financial statements are held out as 'separate financial statements' prepared in accordance with AASB Standards, we note there could be auditor reporting implications. For example, an auditor might be able to attest to the truth and fairness of the separate financial statements where they are in accordance with AASB Standards for the separate entity, but presumably would qualify if they are not accompanied by consolidated financial statements. This could affect users' confidence in, and their ability to make decisions based on, the information provided. We suggest the Australian Auditing and Assurance Standards Board (AUASB) is consulted on this issue before the proposals are finalised.

If the proposals proceed, and require some entities to lodge financial statements that are not prepared in accordance with AASB standards, we think users of those financial statements should be fully informed about the quality of the information. Accordingly, where the financial statements do not comply with AASB standards, that fact should be required to be disclosed together with a description of the areas of non-compliance.

We acknowledge that the ACNC, as the regulator, has the responsibility of determining the type of financial reporting it would require for its purposes – however, we note that if the resulting information prescribed by ACNC is not in compliance with AASB Standards and the registered entity is a reporting entity, there may be circumstances where that entity would be required to prepare general purpose financial statements in accordance with current AASB Standards in addition to meeting its ACNC reporting obligations.

### ***Creating Standards for non-reporting entities/special purpose financial statements***

On page 3, the Explanatory Material states that "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."

Consistent with our introductory comments above, we note that the AASB sets accounting standards only for general purpose financial statements (Tier 1 for entities with public accountability<sup>1</sup> and Tier 2 [RDR] for other entities), and those standards address not-for-profit (including charity) accounting issues. The AASB has no plans to create another tier of reporting requirements. We think the current suite of Standards, and the process for maintaining those Standards, is sufficient to meet the needs of users of general purpose financial statements.

### ***Other comments***

#### ***Reporting entity statistics***

On page 5 of the Explanatory Material, statistics based on ASIC data provide an indication of the proportion of medium and large companies limited by guarantee that report as reporting entities compared with as non-reporting entities. For your information, the preliminary results of recent research commissioned by the AASB on financial statements lodged with ASIC is expected to be published in the first half of 2013 and may provide more detailed findings on the extent of general purpose financial statements versus special

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<sup>1</sup> Public accountability is defined in AASB 1053 *Application of Tiers of Australian Accounting Standards* and identifies for-profit entities required to apply Tier 1 requirements. The notion of public accountability in the context of AASB 1053 is not relevant to not-for-profit entities.

purpose financial statements. We would be willing to provide the results of that research once it has been finalised. The results will inform the AASB's reconsideration of the reporting entity model noted in our introductory comments.

On pages 6 and 7, the Explanatory Material lists actual names of medium and large entities that classify themselves as reporting entities and non-reporting entities. We are concerned that the list inappropriately implies that those classifications provide guidance/precedence for entities that perceive themselves as similar to the entities listed. We are not convinced that all those entities listed as classifying themselves as non-reporting are appropriately classified. Preliminary results from our research indicate that the concept of reporting entity may not have been applied consistently in practice.

#### *True and fair view*

On page 9, the Explanatory Material notes that "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." Whilst the sentiment of this is clear, we are concerned that the requirements as expressed and structured in draft Regulation 8 are unclear and potentially confusing. They could perhaps be more clearly expressed along the lines of:

- (a) the financial statements are those prepared in accordance with the accounting standards, subject to 8(4) and 8(5) [*although see our concerns about 8(5) re non-compliance with AASB Standards above*]; and
- (b) if the financial statements would not otherwise give a true and fair view ... additional information must be included in the notes to the financial statements to achieve a true and fair view.

We note that such a drafting approach would be more consistent with the approach taken to 'true and fair' in AASB 101 *Presentation of Financial Statements* (see, for example, paragraphs 17 and 19-24 of AASB 101).

#### *Requirements of non-reporting entities under the Corporations Act*

On page 3, the Explanatory Material correctly notes that AASB 101, AASB 107, AASB 108, AASB 1031 and AASB 1048 currently apply to an entity, irrespective of whether it is a reporting entity or non-reporting entity. For completeness, we note that AASB 1054 *Australian Additional Disclosures* is currently similarly applicable.

Also, on page 3, the Explanatory Material states that "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." Whilst this statement is accurate to the extent it suggests that the five standards contribute to providing a true and fair view, we are concerned that some might read the sentence as suggesting that adoption of only those five standards gives a true and fair view. However, the view reflected in AASB Standards is that compliance with all applicable accounting standards (not just the five that are listed above) is necessary to present a true and fair view for general purpose financial statements (see paragraph Aus19.1 of AASB 101 *Presentation of Financial Statements*), and we suggest this is made clear in the Explanatory Material.

### *Reduced Disclosure Requirements (RDR) for General Purpose Financial Reports (GPFRs)*

On page 7, the Explanatory Material states that “Those registered entities that are required to prepare GPFRs have the option of applying a **significantly** less onerous disclosure regime …” (emphasis added). We note that the level of reduction of disclosures would depend on the particular circumstances of an entity. Although Tier 2 general purpose financial reporting disclosure requirements are significantly less onerous than Tier 1 general purpose financial reporting disclosure requirements, it might not be the case for a particular entity depending on the nature of its transactions and other events.

### *Relief regarding comparatives in first year of application*

On page 11, the Explanatory Material notes that “As a transitional arrangement, entities will not be required to disclose comparative year information in the first year.” We think such relief would only be appropriate for entities that were not previously required to prepare financial statements in accordance with AASB Standards under any superseded requirements. We also note that a consequence of providing such relief is that the resulting financial statements would not be in compliance with AASB Standards (see for example paragraph 21 of *AASB 1 First-time Adoption of Australian Accounting Standards*, which requires the inclusion of comparative information) and therefore would not be general purpose financial statements.

### *The revenue threshold*

On page 1, the Explanatory Material specifies the thresholds for small, medium and large registered entities. We note that the way they are expressed, by not referring to economic groups, could provide structuring opportunities for otherwise medium/large entities to avoid the reporting requirements.

Of a less significant note, also on page 1, the Explanatory Material states that “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 following year” (emphasis added). We note that ‘extraordinary’ seems to be quite a high hurdle, and question whether it is intended to be so high. We also note that the term ‘extraordinary’ has had a troubled history in accounting standards, as is evident from paragraph 87 of *AASB 101 Presentation of Financial Statements*, which does not permit an entity to present any items of income or expense as extraordinary items in the statement(s) presenting profit or loss and other comprehensive income, or in the notes. We therefore suggest consideration is given to avoiding the use of the term. However, whilst we acknowledge that the proposal is not directly related to an accounting standards issue, from our experience with the term ‘extraordinary’, if the term is retained, we think it would be useful to clarify its meaning, and in particular clarify its meaning relative to ‘abnormal’ or ‘unusual’.

### *The nature of reviews*

On page 12, in the second paragraph, the Explanatory Material provides an explanation of a review. We find the explanation incomplete and suggest that additional material is drawn from the Auditing Standards about the nature of reviews (for example, paragraph 16 of AUASB Standard on Review Engagements ASRE 2400 *Reviews of Financial Reports*

*Performed by an Assurance Practitioner Who is Not the Auditor of the Entity*, on the objective of a review). Again, we suggest that the AUASB is further consulted on this matter before the proposals are finalised.

We hope these comments are helpful in progressing the development of the ACNC Regulation. If you would like to follow up on any of the issues raised, or other matters related to financial reporting and AASB Standards, please do not hesitate to contact Robert Keys, AASB Technical Director, on 03 9617 7624 or at [rkeys@aasb.gov.au](mailto:rkeys@aasb.gov.au).

Yours sincerely,



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