

Lessons on reporting to the Australian Charities and Not-for-profits Commission

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The Australian Charities and Not-for-profits Commission (ACNC) conducts proportionate, risk-based monitoring of annual financial reports and Annual Information Statements as part of our compliance program.

This detailed report aims to explain some of the material issues/errors identified and the results of this compliance activity in relation to the 2014 financial reporting period.

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Reporting obligations

The objective of our monitoring activities on financial reports in 2014 was to:

- Improve the quality of information on the ACNC register
- Ensure charities have a good understanding of the reporting obligations
- Educate of the entire sector on improved financial reporting

All of these aims fall within one of the overall objects of the ACNC to:

‘maintain, protect and enhance public trust and confidence in the sector through increased accountability and transparency’

Current 2014 reporting statistics

At the time of preparing this paper (in June 2014) the following 2014 Annual Information Statement and Annual Financial Report information had been submitted with the ACNC:

- 32,519 charities had filed 2014 Annual Information Statements. Of these 21,317 charities were small, 5,420 charities were medium and 5,782 charities were large
- 5,331 charities classified themselves as Basic Religious Charities and did not provide any financial information (4,515 small, 653 medium, 163 large)
- 4,563 medium charities had submitted an annual financial report and 5,319 large charities had submitted an annual financial report
- 11,136 small charities indicated they used cash accounting, 4,481 small charities indicated they used accrual accounting and 3,215 small charities indicated they did not report
- 3,241 medium charities indicated they provided general purpose financial statements and 1,450 indicated they provided special purpose financial statements
- 3,668 large charities indicated they provided general purpose financial statements and 1,524 indicated they provided special purpose financial statements
- 9,688 charities indicated that the report they submitted to the ACNC had also been provided to a state/territory regulator (5,117 small, 2,353 medium and 2,218 large)

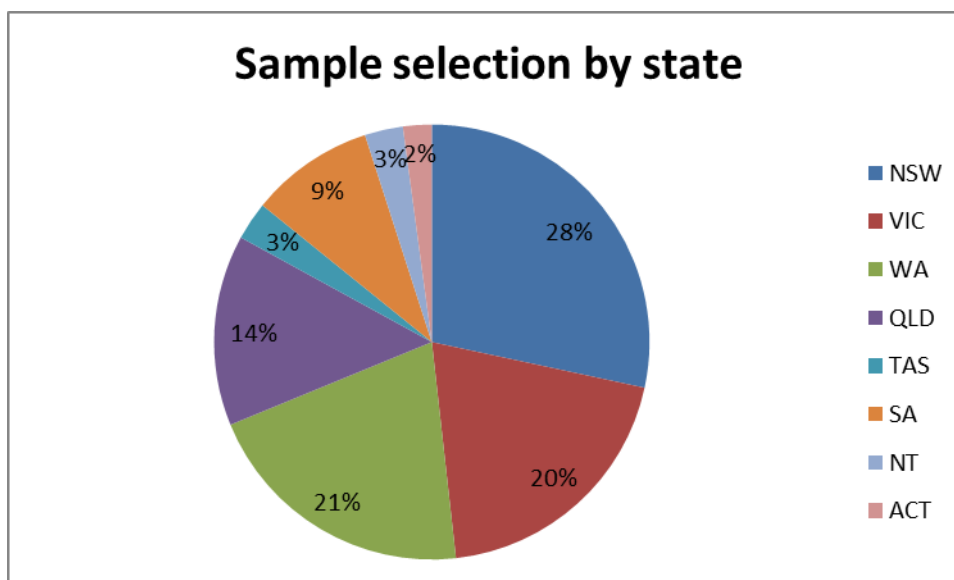


Selection of accounts for review

Our risk-based sample selection took into account sufficient coverage of each state and territory, focused on an almost equal mix between medium and large charities and ensured a good distribution between general and special purpose financial statements.

We supplemented this charity selection with specific reviews for the following scenarios assessed at a particular point in time:

- charities that classified as small but the revenue numbers provided in their Annual Information Statement exceeded \$250,000, and therefore potentially misclassified and should have been medium or large charities
- medium and large charities that had submitted an Annual Information Statement for the 2014 reporting period and no corresponding annual financial report were submitted
- charities that failed to provide any financial information despite having conducted activities or owning significant assets
- religious charities that may have wrongly self-assessed themselves as a basic religious charity and therefore failed to supply the required financial information



Desk top review

Desk top reviews were performed on the individual charities selected for review, amounting to one hundred and forty one charities. This involved review of the



publicly available Annual Information Statement and annual financial report to identify the following:

- Correct size classification
- Annual financial report agrees to Annual Information Statement financial information and report type
- Annual financial report references to Australian Charities and Not-for-profits Commission Act 2012 (ACNC Act)
- Audit/review report and responsible entity declaration attached and signed
- Compliance with the minimum accounting standards required under the Australian Charities and Not-for-profits Commission Regulation 2013 (ACNC Regulations)
- Compliance with related party disclosures required for general purpose financial reports
- Transitional provisions application and appropriateness.



Areas of non-compliance

We focused on three basic financial information errors and then identified a range of Annual Financial Report related non-compliance errors with the ACNC Act. We also identified errors within the non-financial information within the Annual Information Statement. Additional subsets of charities were included in this analysis as well as those that were subject to a desk top review.

Classification errors

The first financial error was the failure of some charities to correctly categorise their size. This could lead to the failure to lodge an annual financial report and the failure to have the information submitted subject to the appropriate audit or review. Twenty seven charities were contacted with estimated charitable assets of \$684m and asked to either confirm or correct their size classification in their Annual Information Statement and provide the appropriate financial report thirteen charities had made the required corrections at the time of preparing this paper.

Of the twenty seven charities, twenty five charities have classified themselves as a 'small'¹ charity, however their revenue/income levels would see the appropriate classification to be 'medium'² or 'large'³. Two charities were medium and their revenue/income level would see the appropriate classification as large.

A further twelve charities were noted in the wrong classification, although no specific contact has been made with the charities in this regard. Most of these related to mis-classification between large and medium charities, which was not considered a huge risk area given similar reporting responsibilities.

Errors in Annual Information Statement financial information completion

The second financial error arose from the incorrect transcribing of annual financial report financial information, selecting the wrong type of financial statements, and calculation errors in the Annual Information Statement. Differences could result in inaccurate data on the ACNC register. We contacted twenty one charities with estimated charitable asset values of \$643m and advised them to correct the data on the Annual Information Statement. Fourteen charities made the required corrections.

¹ Annual revenue is less than \$250,000

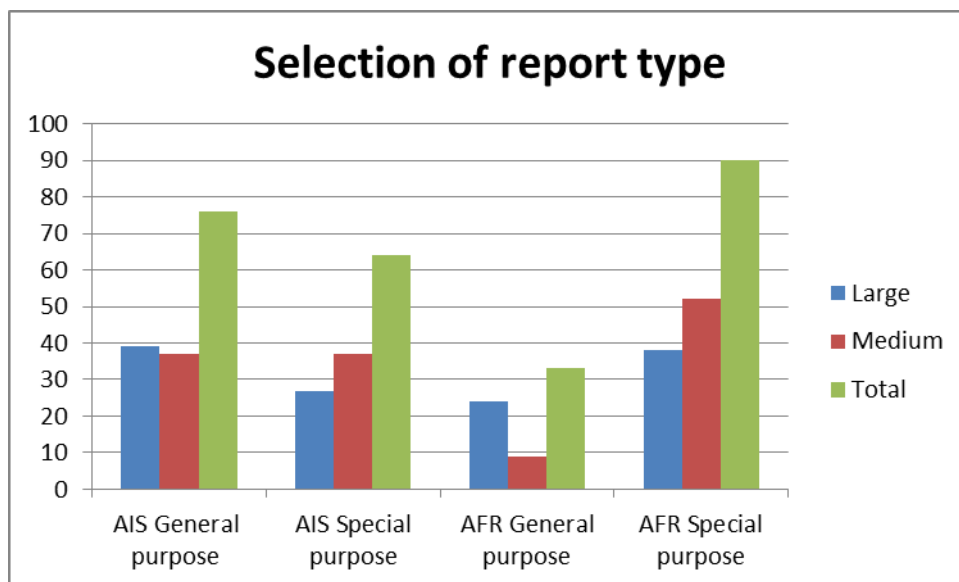
² Annual revenue is \$250,000 or more and less than \$1,000,000

³ Annual revenue is \$1,000,000 or more



These errors occurred due to the following reasons:

- More than half of the errors occurred because the charity had selected 'general purpose' as a report type, when review of the annual financial report determined that the report type was 'special purpose', which may mislead readers about the basis on which the financial information is prepared.
- Cost of sales was not categorised as an expense in the Annual Information Statement but as an offset against revenue
- Other income items (except for gains) in the Annual Information Statement were in fact revenue items in accordance with the relevant accounting standard, which understates their size
- Some charities incorrectly transcribed cents as dollars in the Annual Information Statement, which resulted in over-inflated revenue numbers
- Some charities with investment portfolios included the other comprehensive movements of the unrealised gains on the fair value of the investment portfolios within the profit and loss amounts in the Annual Information Statement (these amounts do not get reflected in the Annual Information Statement profit and loss information at all).





Failure to lodge annual financial report

The third financial error was the failure of medium and large charities to attach an annual financial report with their 2014 Annual Information Statement. Failure of these charities to lodge an annual financial report is a breach of the ACNC Act. Twenty seven charities were contacted with estimated charitable assets of \$240m. In most instances this appears to be a system error and the charity had in fact provided the annual financial report with their 2014 Annual Information Statement. Seventeen charities provided annual financial reports at the time of preparing this paper.

As part of this review we also noted a substantial amount of charities had attached an annual financial report but classified it as their governing document, which occurred mainly in those instances where governing documents had not already been lodged with the ACNC.

We also noticed that some charities lodged an annual financial report which contained the summarised version or a concise set of financial statements instead of the full set of financial statements. Where the annual financial report did contain these shortened versions, a separate document needed to be lodged that contained the full version of the annual financial report. The ACNC Act requires that a full version of the annual financial report be submitted, upon which an audit opinion is provided.

Errors related to the Annual Financial Reports

An analysis of the annual financial reports from the sample selection contained many errors/omissions. Because this was the first year of financial reporting to the ACNC, some entities were covered under the transitional arrangements. These entities should ensure their annual financial reports are compliant with the ACNC Act and the ACNC Regulations for the 2015 reporting period. Almost all of the letters and material issues discovered with charities lodgements above included the identification of errors/omissions within the annual financial report. Where annual financial report errors were identified the charities were also asked to correct and resubmit the 2014 annual financial report or ensure they filed a compliant 2015 annual financial report. An additional three charities with assets totalling \$74 million were identified as having only annual financial report errors.



Most of these errors fell into five categories:

- Not all financial statements were included within the annual financial report
- Accounting policy notes were either non-existent or contained an inadequate basis of preparation and inadequate accounting policy disclosures.
- There were other annual financial report application issues
- Audit/review reports were not included, not complete or not signed
- Responsible entity declarations were not included, not complete or not signed.

Not all financial statements included within the annual financial report

The annual financial report is required to comply with Australian Accounting Standards Board (AASB) 101 *Presentation of Financial Statements*. This standard requires a statement of profit and loss and other comprehensive income, a statement of financial position, a statement of changes in equity and a statement of cash flows. Often, only an income and expenditure statement and a balance sheet were presented as the annual financial report.

Accounting policy note

Eleven per cent of the annual financial reports we reviewed had no basis of preparation note included with the financial statements. The basis of preparation note is still required in transitional financial statements, as shown in the template for first time reporting on the ACNC website. AASB 1054 Australian Additional Disclosures requires the disclosure of:

- whether the financial statements are general purpose or special purpose;
- the statutory basis or other reporting framework under which the financial statements are prepared (we would consider this would refer to any relevant Act under which the annual financial report is prepared and any specific accounting standards that have been adopted in its preparation or a reference to the mandatory accounting standards as required by the ACNC Act); and
- whether, for the purpose of preparing the financial statements, it is a for-profit or not-for-profit entity.

AASB 101 requires significant accounting policies to be disclosed which includes disclosure of the measurement basis used in preparing the financial statements. In reviewing this area we were looking for accounting policies on each material balance sheet item, and detailed revenue accounting policies.

In addition to this, disclosure is required for significant judgements and estimates that management have made in the process of applying the charities' accounting



policies. Judgements could include the depreciation method or the rationale for why financial assets may be classified as held to maturity investments. Estimates could involve those made in assessing recoverable amounts of property, plant and equipment (PP&E), useful lives, estimates involved in measuring employee benefits (such as risk adjustments, discount rates and future changes in salaries). Very few annual financial reports we reviewed had these disclosures, and if they did it was a simply a generic policy with no details on the actual estimates or judgements used in the preparation of the financial statements.

We also remind readers that AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* is one of the six mandatory accounting standards listed in the ACNC Regulations requiring application by medium and large charities not covered by the specific State and Territory transitional reporting provisions. This standard contains required disclosures for charities who make a change in accounting policy, change of an accounting estimate (like an estimate of a useful life of PP&E) and accounting errors that have been identified in the current period that relate to previous accounting periods.

Other annual financial report application issues

Related party transactions

We reviewed various note disclosures in regards to related party transactions. We consider related party transactions an important area as it provides information to users about any possible private benefits that may be provided which may not link to charitable purpose.

Most financial statements reviewed were special purpose financial statements and these statements were not required to and did not adopt the accounting standard AASB 124 *Related Party Disclosures*. However, some of these charities did put some information about related party transactions but these disclosures were not in accordance with the relevant accounting standard.

Those general purpose financial statements that we reviewed were required to comply with AASB 124. Twelve per cent of those general purpose financial statements reviewed did not have a related party note at all. Of those that had a note, only fifty five per cent complied with the required key management personnel (KMP) compensation disclosure (AASB 124.17), and only forty five per cent complied with the related party transaction disclosures (AASB 124.18 & 19).

In regards to disclosures of transactions, either no disclosure was made at all or a generic note stating that 'related party transactions have occurred at normal terms



and conditions'. A generic note does not meet the requirements of the standard to provide the nature, amounts and balances outstanding, by category of related party (which includes KMPs).

In regards to disclosure of compensation, either no disclosure was made or disclosures made of compensation specifically in regards to directors. We note that KMPs are defined as 'those persons having authority and responsibility for planning, directing and controlling the activities of the entity directly or indirectly, including any directors (whether executive or otherwise) of that entity'. This definition would include the CEO of the charity and could even include the direct reports to the CEO, depending on the size of the charity. We do not believe this has been a consistent interpretation of all charities.

Disclosure of expenses

Expenses are required to be disclosed by nature or function (AASB 101.99). However, in twenty one per cent of the annual financial reports we reviewed, we believe the expenses presented were a mixture of nature and function or large amounts were presented in 'Other' with no accompanying explanation.

Statement of Comprehensive Income

Many charities presented the Statement of comprehensive income, but did not have the correct totals listed at the bottom of the page and stopped at 'Net surplus/(deficit) for the year. It is important that other comprehensive income items are considered and disclosed and the correct totals provided in accordance with AASB 101.

Also, some charities that had divisions within their organisation presented several profit and loss statements (and sometimes more than one balance sheet) but did not produce financial statements for the entity as a whole. Financial statements are required to be produced for the charity as a whole. This does not mean that divisional reporting is not allowed, but the financial report for the charity as a whole also needs to be presented.

Balance sheet

Some charities did not present sub-totals for non-current assets, total assets and non-current liabilities and total liabilities, and therefore it was difficult to determine the amounts that related to the Annual Information Statement. It is also not consistent with the requirements of AASB 101. This was a reoccurrence for those charities that produced 'system generated' reports.



Audit/review reports

Section 60.10 of the ACNC Act requires the submission of an audit report for large charities and an audit or review report for medium charities as part of the annual financial report. When an audit is undertaken it must be by a registered company auditor, unless the charity comes under the State and Territory transitional provisions and has another type of auditor in accordance with the relevant State or Territory law.

For twenty one per cent of the annual financial reports we examined, the audit report was not attached, not signed or incomplete. We only sighted one review report in our sample selected.

Some deficiencies noted in the review of audit reports included:

- an emphasis of matter titled 'basis of preparation' (or similar) was not always included where the annual financial report was a special purpose financial statement
- Australian auditing standards had not always been applied
- Reference to the ACNC Act was not usually included in the audit opinion (only relevant for those entities not under the state and territory transitional provisions)

We have not performed a check to ensure those auditors were registered company auditors where relevant, but this may form the basis of a further review in 2015.

Responsible entity declaration

Section 60.15 of the ACNC Regulations requires a responsible entity declaration to be submitted with the annual financial report. For twenty four per cent of the annual financial reports we examined, the responsible entity declaration (or similar as required under state legislation) was either not attached, not signed or incomplete.

Some deficiencies noted in the review of responsible entity declarations included:

- Solvency declaration was missing on a couple of occasions
- Reference to the requirements of the ACNC Act was not usually included.



Errors in Annual Information Statement non-financial information completion

A review of religious charities that have self-assessed as a basic religious charity revealed a number of these charities were incorporated as a company under the Corporations Act 2001 or an incorporated association under any State or Territory Incorporated Association Act, and as such cannot self-assess as a basic religious charity. A small number of religious charities endorsed as a deductible gift recipient have wrongly self-assessed as a basic religious charity. Ninety two charities were contacted to amend that error including providing financial information, which to date has resulted in an additional \$74m charitable assets made transparent on the ACNC Register at the time of writing this paper.

We also selected charities that did not provide any financial information in the Annual Information Statement despite indicating they had conducted activities in the 2014 reporting period. Forty seven charities have been contacted to date which resulted in an additional \$25m charitable assets made transparent on the ACNC Register at the time of writing this paper.

Conclusion

Based on the sample reviewed, it would appear that there is a lack of awareness of the financial reporting requirements of the ACNC by charities. In particular those charities preparing special purpose financial reports are not aware of the six accounting standards that the ACNC requires charities to apply. The focus for the ACNC in addressing the errors would be: communication of the findings of this project to charities, professional bodies and auditors/accountants; improved guidance on the ACNC website including AIS guidance; and improvement in the design of the AIS form. The required inclusions for a financial report will be included in an AIS checklist as well as the AIS guidance.

As 2014 was the first year of financial reporting obligations to the ACNC by charities the focus has been on educating charities of their requirements. For 2015 financial reporting there would be an expectation of improved compliance and a further expansion of review activity.

Resources

www.acnc.gov.au/reporting



Appendix

Summary of reporting obligations

Charities have an ongoing obligation to report to the ACNC. All charities must submit an Annual Information Statement within six months of the end of their reporting period and the information is published on the ACNC Register.⁴ Whilst the 2013 Annual Information Statement only collected non-financial information, the 2014 Annual Information Statement also collected financial information which was proportional based on the size of the charity.

Medium and large sized charities were required to submit an annual financial report with their 2014 Annual Information Statement. Medium sized charities were required to have their annual financial report reviewed or audited, whereas large charities were required to have their annual financial report audited. The annual financial report need to include:

- The registered charity's financial statements, including an income statement, balance sheet, statement of changes in equity and statement of cash flows
- Notes to the financial statements
- The responsible entities' declaration that states whether, in their opinion, there are reasonable grounds to believe that the registered charity 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 ACNC Act.

General purpose financial statements and special purpose financial statements

The ACNC accepts either general purpose financial statements or special purpose financial statements as long as the charity has met the requirements of the ACNC Regulations, being the financial reports must:

- meet applicable Australian Accounting Standards, and
- provide a true and fair view of the charity's financial positions and performance

If the charity is a reporting entity, they must submit general purposes financial statements which must comply with all applicable Australian Accounting Standards however charities can choose whether to report under a reduced disclosure regime.

⁴ Corporations registered with the Office of the Registrar of Indigenous Corporations are not required to lodge Annual Information Statements with the ACNC. In some circumstances charities can ask for some of their Annual Information Statement information to be withheld from the public.



If the charity is not a reporting entity Special purpose financial statement must comply with the minimum following six accounting standards (s60.30 of ACNC Regulations):

- *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*
- *AASB 1048, Interpretation of Standards*
- *AASB 1054, Australian Additional Disclosures*

Transitional reporting arrangements

There were various transitional arrangements affecting the 2014 reporting period. For example, if a charity reported to State or Territory regulators, the ACNC may accept these financial reports as meeting our requirements for the 2014 and 2015 reporting periods. There was also a transitional reporting provision for medium and large sized charities that were not required, under Australian law, to provide a financial report that complied with the Australian Accounting Standards in the 2013 reporting period. These charities only needed to complete the financial information section of the 2014 Annual Information Statement in addition to some basic notes (but this financial information must still have been reviewed or audited).

Duty to provide a corrected statement or report

If a charity identifies a material error in their Annual Information Statement or financial report after they have been submitted, the charity must give a corrected statement or report to the ACNC within either 28 days or 60 days of identifying the error.⁵

It is each charity's obligation to ensure the information it provides in its Annual Information Statement and annual financial report is accurate and meets the requirements of the ACNC legislation and regulations. The ACNC's work in this area is designed to help improve the integrity of the ACNC register and alert all charities to common errors so that they can be avoided in the future.

⁵ The 28-day time frame applies to medium and large charities; the 60-day time frame applies to small charities with annual revenue of less than \$250,000.