THE BOTTOM LINE

Issue 12

Welcome to the latest edition of our financial reporting publication that aims to keep you in the loop with all the latest accounting and financial reporting developments, and the potential impact they may have on your business.

In this issue we look at why adopting Environmental, Social and Governance (or ESG) measures is becoming more important than ever for businesses of all sizes to thrive in the present and also future proof themselves. We explore recent financial reporting developments that will affect registered charities, and remind readers to take action if they have not yet considered the scrapping of SPFS and what this means for them. We close out the issue with two regulatory updates, including the recent changes to the Corporations Act that modernise the way meetings are held.

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FEATURE ARTICLE

The increasing importance of being an ESG-centric business

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Over the past decade, considering ESG policies in the organisational strategy was only expected of global corporations. These were organisations that had extensive and complex relationships with stakeholders involved in their operations. In recent years, business of all sizes, have been increasingly recognising the importance of incorporating ESG in their strategic decision making.

The actions taken by businesses are largely being driven by employees, customers, investors, lenders and government regulators who are demanding that organisations consider how their operations are combatting issues such as climate change, workplace safety and equal opportunity. ESG falls into three different categories – Environmental, Social & Governance. There is no formally agreed-upon list for each ESG pillar, however the World Economic Forum references the following areas:

ESG and impact investing

Investors are increasingly supporting companies through ESG and impact investing. They are choosing to invest in ethical and transparent companies. Lack of consideration for ESG can impact the company bottom line.

A well-known Australian example of this occurrence is the Rio Tinto mine blast. In May 2020, Rio Tinto Ltd faced public outcry after blasting a 46,000-year-old Aboriginal rock shelter to expand its iron ore mine in Western Australia. The action sparked shareholder and investor backlash which affected share price values and resulted in several key resignations. The outcome of the mine blast highlighted the importance of genuine and transparent communications with stakeholders. Investors are increasingly demanding that companies show they are directing funds in ways that protect the environment and communities in which they operate. These are all valuable lessons which all businesses should capitalise on and apply as they plan for growth.

ESG and talent attraction

HLB's latest survey of global business leaders indicated the level of concern regarding talent acquisition had almost doubled. The 2022 report found that 42% of senior executives identified talent acquisition as a business weakness. Leaders shared they were now facing pressure on two ends — attracting the next generation of talent to join their organisations and retaining current employees.

With increased transparency comes opportunity. An ESG-centric business is likely to attract investors as well as talent. People new to the workforce are increasingly seeking to align themselves with companies that support their values. Authentic and transparent communications by organisations may influence recruitment as well as retention of more socially conscious staff.

The global pandemic revealed many businesses are both resilient and nimble. They demonstrated they could quickly adapt to new working conditions which were created by the pandemic. They offered remote working via the greater use of technology, elected to protect jobs through government support and looked after staff by observing health directives. For many this was the first pivot towards an ESG-centric business.

The rise of ESG reporting

Currently EU law requires large public companies to disclose information on the way they operate and manage social and environmental challenges. In 2021 a proposal for a Corporate Sustainability Reporting Directive (CSRD) was presented to the EU. If passed the directive will extend sustainability reporting requirements to all large companies. Listed and larger private companies outside of the EU should be mindful that this directive will be closely monitored by local regulatory authorities.

Australia, like many countries, does not have compulsory sustainability reporting. However publicly listed companies are required to disclose any information that shareholders would reasonably need to make informed investment decisions. There are also recommendations on corporate governance practices around environmental and social risks. Common examples include meeting stated minimum content requirements (both materials and labour), the Workplace Gender Equality Act and voluntary compliance with the Modern Slavery Act.

Next steps for businesses

It is becoming increasingly evident that being an ESG-centric business is important. Businesses need to start to embrace these factors and make the necessary pivot if they are to remain relevant.

It is therefore imperative that businesses take a strategic approach to ESG. Those charged with governance (i.e. the Board of Directors) must consider ESG fundamentals in the company strategy and accept that they are responsible for driving the transition to be more environmentally and socially responsible.

Similar to other changes implemented by businesses, the process will encompass a detailed analysis to examine the merits of altering the product/service offerings and the process of doing business. This includes processes, operations and supply chain management, amongst other factors.

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Financial reporting changes for charities

The revenue thresholds that determine a charity's size have officially been increased, but so too have the disclosure requirements relating to key management personnel (KMP) remuneration and related parties to improve accountability and transparency in the sector.

Highlights

- The revenue thresholds that determine a charity's size have significantly increased with effect from the 2021-22 financial year.
- Large charities that prepare special purpose financial reports will be required to disclose KMP remuneration for the 2021-22 financial year and beyond.
- Medium and large charities that prepare special purpose financial reports will be required to disclose details of related party transactions for years ending 30 June 2023 and thereafter.

The detail

Increased size thresholds

To give effect to Recommendation 12 of the Australian Charities and Not-for-profits Commission (ACNC) Legislative Review, the financial reporting thresholds that determine the size of a charity registered with the ACNC as small, medium or large have increased as follows:

Charity size	Old annual revenue thresholds	Revised annual revenue thresholds
Small	Less than $250,000	Less than $500,000
Medium	$250,000 or more and less than $1 million	$500,000 or more and less than $3 million
Large	$1 million or more	$3 million or more

The revised revenue thresholds are effective for financial years ending on 30 June 2022 and later. In other words, charities will use the revised thresholds when submitting their 2022 and later Annual Information Statements and financial reports.

The increased reporting thresholds will mean that some charities will migrate from being a large charity to a medium charity. These charities will then have the option to have their financial reports reviewed rather than audited.

Those charities that will be classified as small, and no longer medium, under the changed thresholds will no longer have to prepare and lodge financial statements with the ACNC. Instead, they will just be required to submit an Annual Information Statement.

While these reforms can save time, effort and money, charities should be mindful of the benefits that an independent audit or review can bring to the table, such as bolstering the entity's credentials in the eyes of key stakeholders.

It should be noted that the revenue thresholds that apply to companies limited by guarantee (CLG) that are not ACNC-registered charities, as set out in the Corporations Act 2001, have not been changed. There appears to be no immediate intention to align these thresholds with the revised charity thresholds. As a reminder, the revenue thresholds that apply to CLGs under the Corporations Act 2001 are as follows:

	Annual revenue thresholds	Reporting obligations
Tier 1	Less than $250,000	No reporting, audit or review requirements unless requested by members or ASIC
Tier 2	$250,000 or more and less than $1 million	Financial report must be reviewed or audited
Tier 3	$1 million or more	Financial report must be audited

Related party disclosures

Charities that prepare general purpose financial statements (GPFS) are required to include the related party disclosures under either AASB 124 *Related Parties* (Tier 1 entities) or AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* (Tier 2 entities).

However, charities currently preparing special purpose financial statements under the ACNC Act are not required to disclose transactions with related parties. This is because these charities only have to comply with the five mandatory accounting standards, being:

- AASB 101 *Presentation of Financial Statements*
- AASB 107 *Statement of Cash Flows*
- AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*
- AASB 1048 *Interpretation of Standards*; and
- AASB 1054 *Australian Additional Disclosures*.

Under the changes to the Australian Charities and Not-for-profits Commission Regulation 2013 (Regulations), AASB 124 has now been added as a mandatory accounting standard that medium and large charities will have to comply with when preparing special purpose financial reports. For these charities, the Regulations allow a choice to apply all the disclosure requirements of the now six mandatory standards, or the equivalent disclosure requirements contained in AASB 1060.

With respect to related party disclosures other than KMP remuneration, the disclosure requirements in AASB 124 and AASB 1060 are essentially the same.

Entities that choose to present the disclosures under the Simplified Disclosure requirements contained in AASB 1060 are also required to make the special purpose disclosures required by paragraphs 1 to 6, 9, 9A, 9B and 17 of AASB 1054.

As a result of the changes to the Regulations, medium and large registered charities that prepare special purpose financial reports will be required to disclose details of related party transactions in financial statements for years ending on 30 June 2023 and thereafter.

The later effective date will allow charities some time to implement processes and systems to capture related party transactions for reporting purposes.

KMP remuneration

KMP are defined as *"the people with authority and responsibility for planning, directing and controlling the activities of an entity, directly or indirectly, including any director (whether executive or otherwise) of that entity."*

In a charity context, KMP would refer to responsible persons (such as its directors, board or committee members, or trustees) and senior executives (such as the Chief Executive Officer or General Manager, the Chief Financial Officer and the Chief Operations Officer).

KMP might be employed directly by a charity. Remuneration includes all forms of consideration paid, payable or provided by, or on behalf of, a charity, in exchange for services rendered to the charity.

KMP services could be provided to a charity by a separate management entity. KMP remuneration therefore includes amounts incurred for KMP services provided by such a separate management entity.

For years ending 30 June 2022 and later, large charities with two or more KMP that prepare special purpose financial reports will be required to include disclosure of remuneration paid or payable to their KMP as required by either AASB 124 (if applying the six mandatory standards) or AASB 1060 (if applying the equivalent disclosures in AASB 1060).

The disclosures under AASB 124 as they relate to KMP compensation are slightly more onerous than those under AASB 1060 in that they require disaggregation of total KMP remuneration. To address this, it is understood that the ACNC Commissioner intends to exercise discretion and allow large charities with more than one KMP to only disclose the aggregate amount of KMP remuneration for the period, as is permitted by AASB 1060, even where the charity elects to apply AASB 124 and the other five mandatory standards.

Amounts incurred for KMP services provided by a separate management entity will also require disclosure in special purpose financial statements of large charities, irrespective of the number of remunerated KMP. This is done in a separate note in the financial statements.

Large charities must disclose the total amount of KMP remuneration in their Annual Information Statements where they have more than one compensated KMP, or the KMP services are provided by a separate management entity.

Small and medium charities are not required to make the above remuneration disclosures in their special purpose financial reports and Annual Information Statements.

First-time adoption of the new disclosures

In terms of transition, the Regulations do not provide for any relief in the year of adoption of the new disclosures. However, the ACNC Commissioner has exercised discretion and decided that affected charities do not have to provide comparative numbers in the first year of adoption. This applies for related party transactions and KMP compensation disclosures.

The end of SPFS for certain entities is here: Are you ready?

Over the last few years, the Australian Accounting Standards Board (AASB) has been hard at work reforming the Australian financial reporting landscape, specifically with respect to special purpose reporting by for-profit private sector entities. The implementation period for many affected entities is drawing to a close as 30 June 2022 is just around the corner. Hopefully, entities impacted by the reforms have their GPFS house in order.

The entities that will no longer be permitted to prepare special purpose financial statements (SPFS) for years ending 30 June 2022 and thereafter are those required by:

- legislation (e.g. the Corporations Act) to prepare financial statements that comply with Australian Accounting Standards or 'accounting standards'; or
- a constituting (e.g. trust deed) or other document (e.g. loan agreement) created or amended on or after 1 July 2021 and includes, or retains, a requirement to prepare financial statements that comply with Australian Accounting Standards.

These entities must prepare general purpose financial statements (GPFS) for financial years ending 30 June 2022 and beyond. Tier 2 GPFS (as opposed to Tier 1 GPFS) will probably be appropriate as it is unlikely that these entities will have public accountability (as defined in AASB 1053 *Application of Tiers of Australian Accounting Standards*).

Tier 2 GPFS requires compliance with all the recognition and measurement requirements in Australian Accounting Standards, including those relating to consolidation and equity accounting. In terms of disclosures in the financial statements, Tier 2 entities are required to apply the new Simplified Disclosures that replaced the Reduced Disclosure Requirements (RDR) with effect from 1 July 2021 (that is, for years ending 30 June 2022 and later).

The new Simplified Disclosures are contained in a standalone standard, namely *AASB 1060 General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities*.

Entities that prepare Tier 2 RDR financial reports will also be impacted in that they too will have to adopt the new Simplified Disclosures for years ending 30 June 2022 and beyond. Since these entities already prepare GPFS, there is no change to how the numbers are derived since the recognition and measurement requirements under Tier 2 remain unchanged.

Entities that currently prepare SPFS, especially June reporters, that have not yet evaluated if and how they are impacted by the reforms should do so with some sense of urgency. The extent of impact on entities ranges and will very much depend on the degree to which an entity currently complies with the recognition and measurement provisions in Australian Accounting Standards, as well as the existing level of disclosures it makes in its SPFS. One of the biggest anticipated challenges in transitioning to GPFS for the first time is consolidating subsidiaries where this has not been done in the past.

Entities that currently prepare SPFS should:

1. Evaluate if they are captured by the reforms

This may entail reading governing and other documents such as bank or loan agreements to identify the financial reporting requirements contained therein. A requirement to prepare financial statements in accordance with *Australian Accounting Standards* may trigger GPFS depending on the date the document was created or amended (before or after 1 July 2021).

2. Understand their current accounting policies

The aim of this exercise is to identify those policies that are not in line with the requirements of Australian Accounting Standards. For example, if operating leases (other than short-term leases or leases of low value assets) are not recognised on the statement of financial position, this does not comply with AASB 16 *Leases*. Or if the entity does not account for deferred tax, this is not in compliance with AASB 112 *Income Taxes*. Adjustments to opening retained earnings of the comparative period (i.e. at 1 July 2020 for a 30 June 2022 balance date) will be needed to 'fix' the numbers so they reflect all the requirements of Australian Accounting Standards as at date of transition. This includes accounting for subsidiaries that historically have not been consolidated under the requirements of AASB 10 *Consolidated Financial Statements*.

3. Identify and make disclosures required by AASB 1060

Moving from the minimum disclosures required in SPFS to the new Simplified Disclosures could mean a substantial elevation in the information to be disclosed, depending on the nature of an entity's

business. In particular, common areas such as revenue, tax, related parties, leases and financial assets will require some attention. Comparative numbers must be provided in the first set of GPFS prepared for years ending 30 June 2022 and later (relief from doing so was afforded only to early adopters). Collating the required information for disclosure purposes could involve some effort especially where accounting systems are unsophisticated.

4. Engage early with auditors

As can be seen from the above, there is a lot for entities to think about when transitioning to GPFS for the first time. Engaging with auditors sooner rather than later will mean they can assist in navigating any complexities that arise during the transition process. Furthermore, auditors will be in a better position to then verify any transitional adjustments and review new financial statement disclosures, including those relating to transition.

Additional disclosures to be mandated for certain for-profit entities preparing SPFS

Those for-profit private sector entities that are required by their constituting document or another document, created before 1 July 2021 and not amended on or after that date, to prepare financial statements that comply with Australian Accounting Standards will have to make additional accounting policy disclosures in their financial statements going forward.

The AASB has confirmed that it will proceed with the proposals it originally set out in ED 302 *Amendments to Australian Accounting Standards – Disclosures in Special Purpose Financial Statements of Certain For Profit Private Sector Entities*, plus a few changes.

The amendments are targeted at those for-profit private sector entities that will be able to continue to prepare SPFS despite the special purpose reporting reforms because:

- their constituting or other document requires the preparation of financial statements that comply with *Australian Accounting Standards*; **and**
- such document was created prior to *1 July 2021 and has not been amended subsequently*.

Note that where a constituting or other document that refers to Australian Accounting Standards was created before 1 July 2021 but is then modified in any way after that date, and the reference to Australian Accounting Standards is retained (whether intentionally or not), the entity will have to prepare GPFS for year ends that follow.

The purpose of the extra disclosures is to inform users of special purpose financial reports that refer to 'Australian Accounting Standards' of the basis on which those financial statements have been prepared.

The additional disclosures that will be required by impacted entities are as follows:

- the reason the entity is preparing SPFS
- the material accounting policies applied in the SPFS
- where individual material accounting policies do not comply with the recognition and measurement requirements of Australian Accounting Standards, an indication of how those individual policies do not comply
- whether the entity has consolidated subsidiaries and equity accounted investments in associates and joint ventures, where applicable
- whether or not the financial statements comply overall with all the recognition and measurement requirements in Australian Accounting Standards.

Furthermore, these entities will also have to disclose in the notes certain information required by AASB 1054 *Australian Additional Disclosures*, namely:

- the entity's reporting framework and for-profit status for the purposes of preparing financial statements (paragraph 8 of AASB 1054)
- the fact that the financial statements are SPFS (paragraph 9 of AASB 1054).

The final amending standard that will mandate the additional disclosures for certain for-profit entities is expected to be issued very shortly. It will apply to annual reporting periods ending on or after 30 June 2022, however earlier application is permitted.

Temporary measures made permanent to modernise meetings under the Corporations Act

The *Corporations Amendment (Meetings and Documents) Bill 2021* (Bill) received Royal Assent on 22 February 2022 and makes permanent changes to the Corporations Act that allow companies and registered schemes to use technology to hold meetings.

Since 14 August 2021, companies and registered schemes have had to rely on temporary relief measures in the Corporations Act to use technology to conduct meetings, including annual general meetings (AGMs). These temporary measures remained in effect until 31 March 2022. The Bill, however, makes the changes to the Corporations Act permanent and applies to meetings held on or after 1 April 2022.

Under the changes introduced by the Bill, companies and registered schemes can hold meetings of members in hybrid format (i.e. a combination of using one or more physical venues as well as virtual meeting technology). Wholly virtual meetings will also be allowed but only where such meetings are expressly required or permitted by a company's or registered scheme's constitution.

While the permanent changes to the Corporations Act arising from the Bill are effective for meetings that take place on or after 1 April 2022, entities may not be able to hold entirely virtual meetings after this date as their constitution does not explicitly require or permit meetings in this format.

On 2 March 2022, the Australian Securities and Investments Commission (ASIC) issued ASIC Corporations (Virtual-only Meetings) Instrument 2022/129 (ASIC Instrument) which allows additional time for certain companies and registered schemes to hold virtual-only meetings, even where their constitution does not expressly permit this as required under the modifications to the Corporations Act discussed above.

The additional time afforded to entities to hold virtual-only meetings under the ASIC Instrument is as follows:

- Listed companies: an additional two months (i.e. up until 31 May 2022)
- Registered schemes (listed and unlisted): an additional two months (i.e. up until 31 May 2022)
- Unlisted companies: an additional three months (i.e. up until 30 June 2022)

Importantly, in order to take advantage of the relief, the board of directors of a company or the responsible entity of a registered scheme must pass a resolution that it would be unreasonable for the company or registered scheme to hold a meeting of its members, wholly or partially, at one or more physical venues due to the impact of COVID-19.

Where a company's or registered scheme's constitution does not currently explicitly require or permit the use of entirely virtual meetings, the entity will need to consider whether it should seek the necessary member approval to amend its constitution accordingly. This could be done at a wholly virtual meeting (such as an AGM) held on a date before the deadlines listed above.

For more information regarding the ASIC Instrument, refer to ASIC's media release 22-035MR.

"Wholly virtual meetings will also be allowed but only where such meetings are expressly required or permitted by a company's or registered scheme's constitution."

ASIC takes action against companies for financial reporting failings

Companies are reminded of their statutory obligations to lodge financial reports and hold AGMs within the required timeframes. Failure to do so could have consequences.

In a recent media announcement (22-022MR), ASIC announced that it had taken action against seven companies during the period 1 July 2021 and 31 December 2021 for failing to meet their financial reporting obligations, sending a warning that it will continue to prosecute those companies that routinely fail to do so.

Financial penalties for failing to lodge annual and half-year financial reports ranged from $4,000 to $50,000. In the most severe case of the seven reported in the announcement, a previously ASX-listed company was fined $300,000 for failing to lodge one annual report and one half-year report, failing to hold an AGM, report to its members for a particular year, and have a company secretary and at least three directors for a period of time.

The table below serves as a reminder to companies of the provisions of the Corporations Act that impose financial reporting obligations on them:

Section of the Corporations Act	Requirement
s292	All disclosing entities, public companies, large proprietary companies and registered schemes are required to prepare financial reports for each financial year
s319	Disclosing entities and registered schemes must lodge complete financial reports within three months of the end of the financial year while all other entities must do so within four months after the end of the financial year
s302	Disclosing entities are required to prepare financial reports each half-year
s320	Disclosing entities are required to prepare or obtain a report for a half-year and lodge the report with ASIC within 75 days after the end of the half-year
s250N	Public companies must hold AGMS within 18 months after registration and at least once every calendar year and within five months after the end of the financial year

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