19 July 2012

Committee Secretary
Standing Committee on Economics
PO Box 6021
Parliament House
CANBERRA ACT 2600
AUSTRALIA

By Email

Dear Sir/Madam

Re: Inquiry into the Exposure Draft Australian Charities and Not-for-profits Commission Bill

I am making this submission on the basis of my professional standing as a Fellow of the Institute of Chartered Accountants and as a retired partner of PriceWaterhouse Coopers as well as through my recent experience as a governance risk and compliance advisor to a range of not-for-profit ("NFP") organisations.

My submission draws on the potential impact of the Bill on a particular not-for-profit organisation for which I am both a Director and Treasurer. This organisation (which for purposes of this submission I will refer to as "R Inc.") currently brings in about $800k per annum and is therefore towards the upper end of what the Bill defines as a "medium registered entity". The organisation is currently pursuing an aggressive fundraising strategy, which would, if successful, bring it to the cusp of becoming a "large registered entity".

My co-directors will be looking to me for guidance in relation to the provisions of Chapter 6 "Reporting and Record Keeping". In this context, I wish to draw attention to four matters which threaten to divert the attention of directors away from the core purpose of their organisations – and hence the success of the proposed legislation.

1. There is insufficient time to satisfactorily develop and communicate workable financial reporting regulations(refer 6.51);
2. The pivotal concept of "Annual Revenue" is inherently subjective (6,23 and 6.27)
3. The proportional reporting provisions and the ACNC's discretionary powers in relation thereto are impractical (6.28 to 6.30); and
4. The review provisions in relation to the financial report of medium entities (6.90 to 6.106) are impractical.

These matters are discussed in more detail below

1. Financial Reporting Regulations

In its comments on the "Discussion Paper Australian Charities and Not-for-profits Commission: Implementation design" dated 12 February, the Australian Accounting Standards Board (AASB) raised some major conceptual issues associated with the deceptively simple provision that "the financial report will be based on accounting standards issued by the AASB" (refer 6.51).

In doing so it did not address the limited knowledge of these conceptual issues within the NFP sector – or the practical problems that organisations like R Inc. would have to overcome if forced to consider them.

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The first of these concerns was the nexus between Special Purpose Financial Statements (SPFS) – as currently prepared by organisations like R Inc. - and General Purpose Financial Statements (GPFS) of the type the Bill's standardised approach would suggest.

At R Inc., we would have to up-skill and extend the hours of our bookkeeper to make this change and employ an advisor to assist during the transition. It is not feasible to expect us. - and the myriad of organisations like us - to establish the requisite recording policies and procedures by 1 July next year.

2. Annual Revenue

As the AASB point out in the submission noted above, "Annual Revenue" is not a clear unambiguous measure for purposes of distinguishing between small medium and large organisations. In developing a differential reporting framework for use by society as a whole, accountants themselves have deliberately avoided using revenue or turnover as a measure of relative size or complexity. Future generations of accountants will be taught that revenue is a highly subjective measure. The recording and reporting provisions of the Bill (6.23 and 6.27) rest on very shaky ground.

It is commonplace for organisations to raise money to support projects and initiatives which extend beyond one year. When should the revenue be brought to account – when it is pledged, when it is received or when it is applied? These and questions like them threaten the workability of the framework. The sizeable grey area involved will multiply many fold if current proposals to attach a monetary value to the services of volunteers are ever built in to accounting standards.

The distinction between small, medium and large organisations is central to the legislation. It should therefore be based on clear objective criteria. A workable solution will take time to develop.

3. Proportional Reporting Provisions

The Bill allows the ACNC to use its discretion to exempt a medium organisation from the more onerous provisions facing a large organisation if it enjoys a one-off spike in revenue (6.28 to 6.30). In the absence of clear prior advice that an exemption will be granted, the typical director will almost certainly act to eliminate the possibility of prosecution under the Act by assuming that the organisation will be held to the higher standard.

For the sake of clarity, the Bill ought to be amended so that organisations will be expected to report on the basis of revenue for the preceding year unless they are given exemption no less than 2 months prior to the commencement of the reporting year. This would effectively give an organisation enjoying sustained growth a full year to make the transition to more exacting reporting requirements. However it would provide directors with the measure of certainty they require to appropriately balance their priorities.

4. Review Provisions

The Bill provides that medium sized entities can opt to have their accounts reviewed rather than audited (6.90 to 6.106).

As a practical matter it will be difficult for reviewers to undertake sufficient work to provide directors – and the ACNC – with any meaningful comfort that their financial reports are "free of material misstatement".

Reviews of this type are generally confined to the half yearly accounts of listed entities when the review procedures are buttressed by audit procedures designed to support a full audit opinion for the surrounding 12 months. These reviews tend to draw on the sophisticated management reporting regimes listed companies are able to develop and maintain.

Few qualified accountants working in the NFP sector have the requisite skill and experience to undertake comfort reviews of this type – and to the extent that smaller organisations have limited capacity to apply strong independent management controls – it is highly likely that the work involved would be similar to the work involved in a full audit.

Medium sized organisations should be encouraged to have their accounts audited and any review option should be hedged on the basis that full audits ought to be undertaken every second year and that the cost savings involved in the review option are unlikely to be significant.

I am keen to see the Bill succeed and I recognise that a measure of short term pain may be necessary to achieve long term gain. But the four points I have raised are major hurdles which threaten the credibility of the Commission and the efficiency of the sector.

Yours faithfully

Alan S Fotheringham
Director
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