



ABN 28 000 030 179

2 September 2008

Committee Secretary
Senate Economics Committee
Department of the Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600

Email: economics.sen@aph.gov.au

Dear Sir

Re: Inquiry into the Disclosure Regimes for Charities and Not-for-Profit Organisations

Thank you for the opportunity for The Smith Family and others in the not-for-profit sector to provide input into the *Inquiry into the Disclosure Regimes for Charities and Not-for-Profit Organisations*. The Smith Family's comments are made in the context of the not-for-profit sector but from the perspective of companies limited by guarantee.

Background

As an independent non-profit social enterprise, The Smith Family works in 95 communities nationally to achieve its mission of unlocking opportunities for financially disadvantaged Australian families, allowing them to participate more fully in society.

Our facilitation of this participation is supported by the engagement of individuals and groups within the community with the capacity to give time, talent and dollars. As a result, the spectrum of The Smith Family's stakeholders is very broad, connecting the people we help to individual sponsors, donors, corporates, government and academia, with each group having its own accountability expectations of the organisation which may include reliance on both financial and other measures.

Our vision of creating a more caring and cohesive society is premised upon the family as the central supporting entity for achieving sustainable change at a community level. Drawing on evidence pointing to the importance of family relationships and the home environment in the

Level 9
117 Clarence Street
GPO Box 10500
Sydney NSW 2001

Telephone (02) 9085 7100
Facsimile (02) 9085 7295
Email ben.watkinson@thesmithfamily.com.au
www.thesmithfamily.com.au

healthy development of children, The Smith Family has adopted a dual-generational approach, recognising that while education is the key to breaking the cycle of disadvantage, any investment that is made in children must be complemented by providing support to parents to act as role models and create a home environment which is conducive to learning.

This focus on individuals and families is supported by our work in building sustainable, broader and more responsive support systems for families at a community level, reforming traditional 'silo' service delivery into an holistic, accessible and integrated system.

Our 'whole of community' approach has led The Smith Family to collocate itself in the schools where the students are studying. Embedding our support in this way strengthens the relationship between families and schools, which in turn builds the social capital and broader cohesion of the community, leading to a greater degree of sustainability.

RESPONDING TO THE INQUIRY

1. Concerns about the not-for-profit sector

Are current disclosure regimes for not-for-profit organisations adequate?

While there is an argument for maintaining full disclosures which is linked to a need for transparency and comprehensive reporting to stakeholders, the fragmentation of legal structures in the not-for-profit sector and the attendant differences in reporting and disclosure requirements make comparability extremely difficult for all the reasons identified in the *Choice* article cited in the Inquiry's Background Paper.

The Smith Family's experience is that relatively few stakeholders actually examine financial statements in detail, or indeed ask for copies of them. The Smith Family as a company limited by guarantee is required to provide financial statements to its members. This is done in concise form, although in general the requirements for financial information of our members and of individual donors as a group are met by summary information provided in Annual Reports.

We also provide copies of our financial statements and Annual Reports to many of our corporate partners, and to government departments and agencies in meeting grant acquittal requirements. We rarely field questions on them from stakeholders, and while they obviously contain the information which is required under the Corporations Law and, where applicable, state-based legislation and regulations alluded to below, this is not to say that from a stakeholder perspective they need to contain all of that information.

Providing summarised information (as we do in our concise financial statements) satisfies most stakeholders, but there are still benefits in the detailed process which underlies the preparation of

these statements in terms of providing comfort in governance processes, evidence of detailed external review and the like.

Recent changes to the financial reporting framework for companies in Australia have had several impacts on companies limited by guarantee, in line with those for other public companies because the reporting requirements under accounting standards (though not ASX requirements) are essentially the same. Increased auditor regulation has led to increased costs for companies, but with little obvious benefit from a company perspective. The introduction of Australian equivalents to International Financial Reporting Standards highlighted anomalies between the operations of for-profit and not-for-profit entities which required a number of 'carve-outs' for not-for-profit companies, although these did not fully address those anomalies. The implementation of further amendments and 'carve-outs' is likely to be an ongoing process.

The reporting position for not-for-profit organisations operating in more than one state or territory is made more complex by differing reporting requirements in each jurisdiction. For example, requirements exist differentially for separate audited or unaudited accounts, additional audit certifications and, in the case of financial statements, additional disclosures such as potentially ambiguous ratio analyses, and so on. All of these variables incur additional costs for the sector, particularly for organisations operating in multiple jurisdictions but which report on a consolidated basis. **It would be beneficial for these anomalies to be addressed as part of the Inquiry, with the aim of achieving greater standardisation and comparability of reporting outputs.**

The position is further complicated by fragmented structures among some sector participants such as church-affiliated organisations, some of which may be incorporated as companies, some as associations and others not at all, making it difficult to get a full picture of organisations overall.

It is made even more complex by the alternative corporate structure of incorporated associations in each jurisdiction, each with different reporting requirements. Clearly comparability in the not-for-profit sector is difficult to achieve under current reporting arrangements.

What would be the potential advantages and disadvantages for not-for-profit organisations of moving towards a single national disclosure regime? How might any disadvantages be minimised?

In general there is a case for differential reporting requirements for organisations in the sector, although it should be possible to encompass these within a single flexible disclosure regime. Table 1 of the Discussion Paper entitled *Financial Reporting by Unlisted Public Companies* issued by the Treasury in 2007 highlighted that 70% of companies limited by guarantee have revenues of less than \$1 million. These same organisations are likely to have less complex

business structures and are much smaller in scale than the minority of organisations with higher turnovers.

The exposure draft released in 2007 by the Australian Accounting Standards Board of a proposed IFRS to apply to small and medium entities would apply to companies limited by guarantee with revenue below \$25 million or assets below \$12.5 million, and was expected to change the reporting requirements for the majority of companies limited by guarantee reporting under the current arrangements. The expectation was that for-profit entities covered by the proposed standard would be those with revenue threshold below \$500 million or an asset threshold below \$250 million. While the differential between the two categories is a factor of 10, the information provided on not-for-profit companies in Table 1 of the Discussion Paper indicates that 98% would have revenue below the threshold contemplated by the proposed standard, while 93% would fall below the proposed asset threshold. Therefore a maximum of 7-9% of not-for-profit companies would continue to report under their current arrangements.

With most organisations having revenues of less than \$1 million, consideration could be given to differentiating them from larger organisations by ensuring that the need to comply with all elements of such a standard does not render financial reports meaningless or unusable.

Using size as a delineator is not a simple matter, any more than determining and classifying the nature of the business. It comes down to a need to define the public interest and to what extent it is and could better be served by the disclosure regime(s).

While a dollar figure in revenue and/or assets is probably the simplest measure, and revenue the more relevant measure of the two in the not-for-profit sector, neither is really appropriate by itself. The sector is characterised by raising its funding from a number of sources which also provide a basis for distinguishing the disclosures which may be appropriate. Broadly the sector receives its revenue from fees, government and public/corporate support (see Page 6 below), each with their attendant and very different cost structures. Measures of efficiency such as cost to income ratios inherent in some state fundraising legislation are effectively rendered meaningless because of the significant cost variations related to funding sources, and the different definitions of 'fundraising' itself.

Accepting that all organisations involved in public fundraising need to be accountable and that the question of how best to define the sector (for example, by funding sources or an appropriate revenue and/or asset threshold) is a complex one, **there is a need to balance cost with the public interest, while ensuring at the same time that appropriate recording and controls are in place for dealing with donated resources.** In any case the requirement for audit signoff

will provide comfort to both internal and external stakeholders that the stewardship role of not-for-profits is being fulfilled.

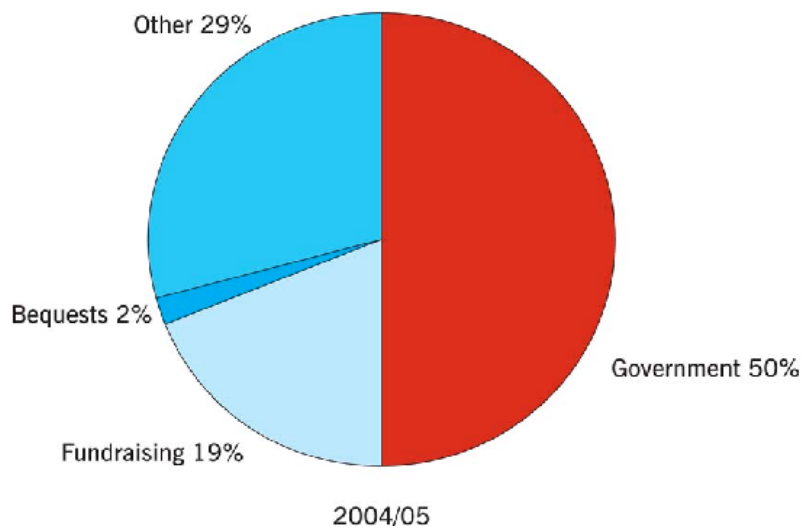
While we have not conducted a detailed review of the proposed standard referred to above, we note that it is broad ranging. It may well be that organisations reporting under its terms would supply most if not all of the financial reporting information required by their stakeholders, but in a more concise and comprehensible form. **On this basis we would expect to argue that the thresholds for the not-for-profit sector may actually be too low.**

Would a standardised disclosure regime assist not-for-profit organisations who undertake fundraising activities, and who operate nationally, to reduce their compliance costs if it meant they would only have to report on fundraising to a single entity (rather than reporting to each state and territory)?

The issue here is more about the multiplicity of reporting requirements than the jurisdictions which require the reports. While ideally there might be standardised methods of reporting results which were applicable to all organisations but which would allow for variable complexity according to criteria such as size and range of activities, realistically there will still be state-based reporting requirements. Standardising those requirements for each jurisdiction is what will reduce compliance costs.

While it may be important for standardisation of requirements be achieved to promote transparency and comparability (and reporting requirements could be standardised, for example to those of the AASB Exposure Draft or even further to those under concise financial reporting rules in the *Corporations Act 2001*), much of the audit work in preparing them would be unchanged from now, and hence there would be limited cost savings to be achieved from such changes.

A similar position regarding standardisation could be taken with acquittals of government grants. Many organisations in this sector receive substantial government funding. Sector data from *Australian Giving Post-Tsunami: Australian Charities Financial Analysis 2004* (Givewell Research Centre, May 2005) indicates the following non-profit sector income sources (excluding hospitals, which of course rely heavily on fee for service income):



Funding is distributed by federal, state, local and statutory bodies and there is little standardisation of terms and conditions or reporting requirements and formats. Often organisations are left to design their own expenditure statements. All of these differential reporting requirements add to the cost base of the sector.

An alternative approach would be for grant acquittals to be supported by and referenced in audited accounts rather than by specific individual audits. This would save both money and time in the sector and cut down on duplication of effort.

If there was to be a nationally consistent disclosure regime, should it apply across all not-for-profit organisations or should different regimes apply to different parts of the sector? For example, should charities be treated differently from other not-for-profit entities?

While companies limited by guarantee share common reporting requirements for providing general purpose financial statements, they are distinguished by the breadth as well as the scale of their activities in the not-for-profit sector, including the provision of nursing care and accommodation, education and other community services, the operation of sporting clubs and the like.

Increasingly, not-for-profit organisations conduct business activities as part of ensuring the sustainability of their community activities. They can provide relatively regular and predictable income streams to meet infrastructure costs and contribute to program development, and the distinction between traditional fundraising and commercial activity may highlight a need for them to report on aspects of their activities in a more conventional commercial way. As an example by way of contrast, a sporting club which operates solely for its members, meeting its expenses

through minor fundraising efforts, is very different from one which operates in a commercial environment with licensed premises.

We believe that the opportunity exists for a common reporting basis to be established, and that properly constructed, it may also serve to cover the reporting requirements of organisations incorporated under state regulations. This in turn will serve to promote comparability across the sector as well as providing reassurance to stakeholders of individual organisations.

Some of the key purposes of financial reporting in the not-for-profit sector are to facilitate comparability, promote transparency and demonstrate good governance practices, and there is a strong argument for standardisation of reporting and disclosure. **While a high degree of standardisation is desirable as a principle, the diversity in both size and purpose of organisations in the not-for-profit sector makes it preferable at a practical level for them to be categorised into like groups which may in turn have fewer or more disclosure requirements than the 'norm'.**

2. Calls for Regulatory Reform

Does there need to be regulatory reform in the not-for-profit sector?

Should there be a single national regulator for the not-for-profit sector?

Should there be a single specialist legal structure for the not-for-profit sector?

The wide variability in the ways that not-for-profit organisations disclose information to the public identified by *Choice* and the attendant lack of comparability are at least indicators that the current multiplicity of structures in the sector generates sub-optimal reporting outcomes which may in turn raise concerns among stakeholders about a lack of transparency and accountability. In a perfect environment this might be addressed by a having a single national regulator for the sector.

Realistically, however, as we have indicated elsewhere in this submission, Australia's federal structure makes this difficult, and there would be a significant risk that a national regulator would become simply one more body to which a sometimes heavily regulated sector would be required to report, adding another layer of cost and technical complexity to organisations which typically find their resources badly stretched as it is.

We see a role for a national body of some sort which is focused more broadly on adding value to the sector by:

- **Reducing the current burden of regulation which sees many organisations reporting to the Commonwealth and every State and Territory government at least annually**
- **Reducing the heavy proportional emphasis on *outputs* and *efficiency* in favour of a greater emphasis on *outcomes* and *effectiveness* at both the governance and program performance levels**
- **Ensuring that the regulatory burden on the sector is commensurate with its capacity to comply, recognising that over-regulation is counter-productive.**

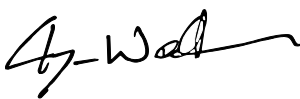
The implementation of a national regulator should only be considered where its role replaces those of other regulatory bodies, including current federal and state-based regulators. An interim step might be to develop a standardised structure and reporting regime within the existing regulatory framework. One approach could be described as working at three levels:

- **Companies** (limited by guarantee and in other ways such as by legislation or charter) – typically larger, multi-state organisations;
- **Incorporated associations** – typically state-based but with standardised accountability rules rather than the variety which exists at present; and
- **Special purpose reporting** (such as government grants, corporate sponsorships and the like) with standardised disclosures, funding terms and conditions, etc.

Separate consideration would be required of the criteria which would determine which organisations fell into each of the first two categories, and this in turn would help to determine the nature of the required regulation. Criteria might be turnover or asset value based, geographical, reflective of some assessment of program complexity or stakeholder expectations (including the extent of government and/or public support).

We would be happy to discuss aspects of this submission with you, or to provide additional information, should this be required.

Yours faithfully



Ben Watkinson
Company Secretary