CHARTERED SECRETARIES AUSTRALIA

Leaders in governance

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Senate Economics Committee
Department of the Senate
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Inquiry into the disclosure regimes for charities and not-for-profit organisations

Chartered Secretaries Australia (CSA) welcomes the opportunity to comment on the Inquiry into the disclosure regimes for charities and not-for-profit organisations (NFPs).

CSA is the peak professional body delivering accredited education and the most practical and authoritative training and information on governance, as well as thought leadership in the field. Our members are all involved in governance, corporate administration and compliance with the *Corporations Act* (the Act). Many of our members serve as officers of not-for-profit organisations, or work for or are involved with companies limited by guarantee. CSA itself is a company limited by guarantee, formed to serve the interests of its members, who are governance professionals. We have drawn on their experience in the formulation of our submission on the matters canvassed in the Terms of Reference.

General comments

CSA welcomes the consultation on disclosure regimes for charities and NFPs. Although much-needed reforms for small business have been introduced over recent years, CSA believes that more needs to be done for NFP organisations given the importance of the sector. After more than a decade of a dual NFP regime, with State and Territory-based associations' legislation co-existing with the national regulation of companies, it is time for serious reconsideration of the regulation of NFP bodies generally.

CSA notes that the essence of good governance is stewardship, accountability, transparency and integrity. Any reform of the disclosure regimes for charities and NFPs must balance the reasonableness of compliance requirements and any additional costs attached to altered compliance requirements, particularly for smaller companies, with the need to ensure that stakeholders continue to have confidence in the governance of such companies.

CSA believes that it is important to assess what is meant by governance, to ensure that any reform of the disclosure regime applicable to NFPs is undertaken in the context of understanding. CSA believes that governance means the method by which an organisation is run or governed, over and above its basic legal obligations. It has four critical elements:

- ***transparency***, which entails a true dialogue with a range of stakeholder groups. The starting point is transparency of purpose, clarifying why the organisation exists, what its objectives are and what the measures of achievement are. It also means transparency of process so that all stakeholders understand how things are done as well as why
- ***accountability*** — this means asking the questions: Who is responsible and to whom? What are they responsible for? What are the consequences if the rules are violated? It is a normal part of the exercise of responsibility. It is a reporting mechanism enabling those conferring responsibility to monitor its exercise
- **stewardship**, which involves a clarity in all organisational decision-making so that those controlling the destiny of an organisation do so not for their own benefit, but rather for the benefit of the range of individuals and groups who have an interest in the affairs of the organisation, that is, the stakeholders
- ***integrity*** — developing a culture committed to ethical behaviour. That culture should be about carrying out the responsibilities required by the charter, legislation or constitution in a manner open and apparent to all stakeholders; being accountable for those actions; acknowledging that the good of others overrides any benefit to oneself; and acting ethically.

CSA therefore believes that the need for confidence in the governance of NFPs is essential. Governance is not restricted to 'for-profit' companies. However, it is important to note that the legal and regulatory framework currently in place is devised for 'for-profit' companies and does not assist the information needs of stakeholders in the NFP sector. The members of NFPs (and their stakeholders) want to know the financial position of the organisation, that the organisation is being managed prudently, and that the allocation of resources is aligned with the values and objectives of the organisation as set out in its constitution. The current legal and regulatory framework is designed to facilitate shareholder management and to assist investors to examine the accounts to ascertain the deployment of and return on their investment.

CSA notes that a major survey of NFPs was conducted a few years ago as part of a research project titled *Accountability and Corporate Governance in Not-for-Profit Companies* (the Woodward Report), a three-year project undertaken by the Centre for Corporate Law and Securities Regulation at the University of Melbourne[1], with support from Philanthropy Australia Inc. For the first time, the results provided large-scale, national profile data on NFPs and the legal structures they adopt, and therefore the disclosure regimes under which they operate. CSA commends this report and its recommendations to the Inquiry, as many of the issues canvassed in the Committee's Terms of Reference were dealt with in this report.

CSA also notes that in 2007 The Treasury (Commonwealth) issued a discussion paper titled *Financial Reporting by Unlisted Public Companies* (Treasury Discussion Paper). Many of the issues relating to the relevance and appropriateness of the current disclosure regime for charities and other NFPs were canvassed in the Treasury Discussion Paper. CSA also commends the Treasury Discussion Paper and the submissions lodged in response to it to the Standing Senate Committee on Economics (the Committee). Our submission to The Treasury is attached as Appendix C to this submission.

As reform of company law for 'for-profit companies' has progressed, no such similar reform for NFP companies has occurred. Yet a number of reviews over the past decade have highlighted the issues that need to be addressed and the way forward for a reform process. CSA strongly recommends that the Committee consider the major reviews of the past few years and also consult with the NFP sector and their stakeholders in its consideration, as it is imperative that decisions concerning this sector are not taken without such consultation. The Committee will also need to have regard to the sometimes competing concerns of a range of organisations such as funding bodies, the Australian Taxation Office and State departments administering the Fundraising/Collection Acts as all such parties have requirements of NFP organisations, which results in a great deal of duplication of disclosure obligations.

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[1] Woodward and Marshall, *A Better Framework: Reforming Not-For-Profit Regulation*, 2004, The University of Melbourne (available at: http://cclsr.law.unimelb.edu.au/not%2Dfor%2Dprofit/finalreport/)

Finally, CSA notes that the Inquiry into the Disclosure Regimes for Charities and Not-for-Profit Organisations Background Paper (Background Paper) has formulated many of the questions to be considered by the Committee on the basis of one article published in *Choice* and views expressed by Senator Andrew Murray. Yet the Background Paper makes no reference to the Woodward Report, which is considered the landmark report in this area.

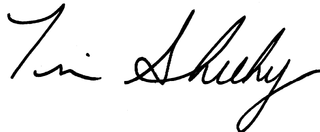
CSA contends that the NFP sector should not be viewed as a sector which is 'broken'. CSA is of the firm belief that a clear public policy to facilitate the sector by clarifying and streamlining the disclosure regime is overdue and commends the important work already carried out on this front in the various reports cited.

CSA would be very concerned if the Committee did not undertake widespread consultation to ensure it is cognisant of the full range of opinion of the NFP sector.

CSA also recommends that the Department of Treasury is the appropriate body to carry forward the streamlining and clarification of a consistent disclosure regime for the NFP sector, under the direction of the Minister for Superannuation and Corporate Law.

Our views on the specific Terms of Reference of this inquiry are set out on the following pages.

Yours sincerely



Tim Sheehy
CHIEF EXECUTIVE

1 The relevance and appropriateness of current disclosure regimes for charities and all other not-for-profit organisations

Current legal framework

Currently people coming together for a common purpose have a choice of legal structure to facilitate the achievement of their objectives. Those choices are:

- proprietary company (these can be small or large)
- public company (listed or unlisted)
- incorporated or unincorporated association
- partnership.

Private (proprietary) and public companies are regulated under the *Corporations Act 2001* (Commonwealth) (the Corporations Act) and incorporated associations are regulated under State and Territory-based legislation. The choice of legal structure affects the disclosure requirements applicable to the organisation. Public companies are open to much greater scrutiny than proprietary companies. Public listed companies have additional disclosure requirements under the Corporations Act and the Australian Securities Exchange (ASX) Listing Rules.

The financial reporting requirements imposed on incorporated associations in each of the State and Territory jurisdictions are, in general, less extensive than the reporting requirements imposed on companies limited by guarantee (one form of unlisted public company).

Appendix A sets out the differences between proprietary and public company structures in Australia, as well as information on the disclosure requirements of each structure.

Treasury's Discussion Paper contains a very useful appendix (Appendix 1 to the Treasury Discussion Paper) setting out the financial reporting requirements for unlisted public companies and incorporated associations.

Current disclosure regime for NFPs

Companies

Financial reports are the primary source of information for users seeking to make an assessment of a company's financial position. Disclosure of financial reports must include the financial statements of the company (balance sheet, profit and loss statement, cash flow statement and statement of recognised income and expense/statement of changes in equity), the notes to the financial statements and a directors' declaration about the statements and the notes. The financial report is required to be prepared in accordance with applicable accounting standards and audited by a registered company auditor in accordance with auditing standards.

The Treasury Discussion Paper noted that:

> The content of the financial report is governed by the accounting standards. The range of accounting standards that apply will depend on whether the company meets the definition of reporting entity in the accounting standards. If the company meets the definition of reporting entity, it must comply with all the requirements in the accounting standards. If it does not meet the definition, it is only required to comply with the recognition and measurement requirements, not the disclosure requirements. Sample data indicates that 64 per cent of companies limited by guarantee and 81 per cent of unlisted public companies limited by shares classify themselves as reporting entities and therefore comply with all the requirements in the accounting standards.

A great many NFP companies can select *not* to be reporting entities and therefore need only produce 'special purpose accounts'. CSA notes that many not-for-profit companies, particularly larger ones, choose to produce full accounts for a variety of reasons (frequently related to the desire to be transparent and accountable) and therefore classify themselves as reporting entities. The important issue is that NFP companies currently have a choice to select 'special purpose accounts', which

choice brings with it a significantly reduced reporting requirement and consequential potential for savings.

The reason behind this choice is that many companies limited by guarantee are small not-for-profit organisations operating for the benefit of members (for example, small sporting clubs), and for such companies, the requirement to apply the same reporting and auditing regime that applies to public listed companies imposes a severe regulatory burden. The members of such companies want to know the financial position of the company and that the company is being managed well, but the current full level of statutory reporting does not fulfil this need. The reporting requirements under the Corporations Act can be onerous for companies limited by guarantee, yet do not necessarily provide member benefit.

Incorporated associations

Disclosure requirements vary from state to state (see Treasury Discussion Paper Appendix 1). The extent to which incorporated associations are required to comply with accounting standards varies between the jurisdictions.

Are current disclosure regimes for NFPs adequate?

The Background Paper points to inconsistency in disclosure in the NFP sector. However, the Background Paper does not differentiate between benevolent NFPs (charities) and other NFPs (for example, professional associations such as CSA). The diversity of the NFP sector needs to be kept in mind when reviewing the adequacy of disclosure.

1 Need to move away from a dual regime

Increasingly, even very small NFPs operate on a national basis, and this is not facilitated by the existing State-based incorporated associations' regime. Added to this is the complexity of some NFPs operating as companies governed by a national scheme. The sector needs a national regulatory framework based on sound public policy, rather than disclosure requirements that vary vastly depending on jurisdiction and the nature of the legal structure adopted and which result in a fragmented and complex regulatory environment for NFPs.

As noted in the Woodward Report:

> The regulatory framework underpins accountability, which in turn underpins confidence in the sector. It is a core issue that needs to be considered even before the related issue of disclosure. The existing two-tiered regulatory system (State/Territory-based incorporated associations and a Federal company law regime) is inefficient, costly and does not meet the needs of small or large NFPs. The special needs of NFPs that are incorporated as companies limited by guarantee have been overlooked in changes to the Corporations Act. Their particular needs have sometimes been prejudiced by changes made at the behest of, or for the benefit of, business. Improvements in the legislative regime are long overdue.

Recommendation 1: Single regulatory regime

CSA recommends a single Commonwealth statutory regime for all corporate bodies (that is, for-profit companies, NFP companies and incorporated associations) by referrals of power from the States to the Commonwealth. Such a referral has already been successfully undertaken with company regulation and if undertaken in relation to NFP regulation, responsibility (in the short term) for registration and ongoing regulation should rest with ASIC.

CSA also recommends that any such single regulatory regime would need to include regulation of public fundraising activities undertaken by NFPs, which is also currently the subject of fragmented and complex State and Territory-based legislation.

2 Need for a minimum standard of governance disclosure

It is common for the directors of NFP organisations to come from backgrounds which carry no experience in organisational administration, financial administration or business management in general. For them, it makes fulfilment of their legal responsibilities as directors that much more difficult. A failure to know those responsibilities is not an acceptable defence after something goes wrong.

It is in the manner of the exercise of their responsibilities in supervising employed managers and staff that directors are most likely to fall into breach of those responsibilities. This can occur not through deliberate intent, or through reckless disregard, but most likely from inadequate reporting, both financial and operational, which equates to inadequate supervision of managers and use of inappropriate administration procedures. The more limited the knowledge and experience of individual directors in these matters, the greater the risk of misadventure.

The key concepts of transparency, accountability, stewardship and integrity remain the cornerstones of governance. On this basis, CSA does not believe that any reform of the disclosure regime for NFPs should be based on any failure by directors or employees to understand their disclosure requirements or implement systems to provide for such disclosure. Whether a board is driven by the bottom line or by a deep-rooted ethical mission, CSA believes that it remains the board's collective responsibility to ensure that the organisation is fit for purpose and to provide strategic direction to enable it to attain its stated goals.

CSA does not support an exemption of any NFPs from a minimum level of financial accountability. The majority of NFPs are tax-exempt and therefore not required to lodge a taxation return. Proper financial statements are essential to ensuring good governance and an understanding of risk management, and without any statutory obligation to lodge annual financial reports, the risk of NFPs (particularly those that do not receive external funding) not preparing such statements is high.

CSA believes that it is the nature of the disclosure — what is required to be disclosed and by whom — that is important, not quantity of disclosure.

NFP organisations have a multiplicity of often complex stakeholder relations to consider (for example, members, volunteers and grant makers — government, private foundations, corporate, the general public). CSA believes that members and stakeholders of all NFP organisations should be able to have access to a report that allows them to know the financial position of the organisation, that the organisation is being managed prudently, that the allocation of resources is aligned with the values and objectives of the organisation as set out in its constitution, as well as who constitutes the governing body and what processes are in place to ensure the personal interests of directors do not override the interests of the organisation.

On this basis, CSA believes that all NFP organisations should continue to be required to maintain proper financial records and accounts; and all NFP organisations should be required to report to an external regulator because of the public nature of their purpose.

However, CSA believes that such accountability could be fostered by requiring a short-form report from all NFPs, with further disclosure and reporting required of some NFPs according to size. This short-form report could be a one or two-page document.

This minimum standard of governance disclosure should be publicly available so that any person seeking to engage with the NFP organisation in any capacity has access to the information. Every NFP organisation, no matter where it is registered in Australia, should apply the same rules and every not-for-profit organisation should be treated in the same manner in relation to this short-form report.

Recommendation 2: Minimum standard of governance disclosure

CSA recommends a mandatory, short-form report for all NFP organisations, which would be publicly available, that would cover:
- statement of objectives of NFP organisation
- the amounts and sources of funding
- the activities that the fundraising supports

- the processes in place, including the risk management processes, to ensure the proper management of all fundraising, activity support, expenditure and staff and volunteers
- details of directors and secretary(s) and their remuneration (including information on whether non-executive board members are paid and whether there are board committees or equivalent)
- disclosure of all related-party interests.

Above this minimum standard of public governance accountability, CSA believes that differential financial reporting obligations based on size are desirable.

3 Need for differential financial reporting obligations

As noted in the Treasury Discussion Paper and in the Woodward report[2], currently almost all not-for-profit companies choose the company limited by guarantee structure. The reasons behind this choice are discussed in further detail on p 11.

The Treasury Discussion Paper notes that:

> There are approximately 11,000 companies limited by guarantee registered under the Corporations Act 2001… the size of these organisations is predominately small with close to 70 per cent having operating revenue of less than $1,000,000… These results are consistent with the findings of a survey of companies limited by guarantee in 2002 by The University of Melbourne which found that 64 per cent had revenue of less than $1,000,000.

Within this context, CSA believes that a differential financial reporting regime is appropriate, and that it should be based on size. Such a differential reporting regime currently operates for proprietary companies. A proprietary company must meet two out of three thresholds in order to gain relief from financial reporting requirements. CSA believes that this differential reporting regime for proprietary companies, based on threshold tests concerning revenue, assets and employee numbers, works well. However, different threshold tests need to be applied to public unlisted companies.

CSA believes that two threshold tests of $1 million in revenue *and* $1 million in assets be used to determine the applicability of financial reporting requirements to companies limited by guarantee. CSA further suggests an added threshold test to protect charities that may possess small classes of assets that may have been donated to them. Thus, if a company limited by guarantee meets *both* threshold tests, they are captured automatically in the financial reporting requirements. If a company limited by guarantee meets one out of the two threshold tests (for example, less than $1 million in revenue but $1.8 million in assets) then the second threshold test rises to $2 million before the automatic capture of the company in financial reporting requirements.

CSA notes that, according to the Treasury Discussion Paper, the use of $1 million in revenue as a threshold provides relief to 68 per cent of companies limited by guarantee. All companies limited by guarantee that do not meet these threshold tests would be automatically exempted from statutory financial reporting. CSA believes that employee numbers should not be used as a threshold test, due to the prevalence of volunteer labour in the NFP sector.

CSA does not support differentiating between companies limited by guarantee based on the nature of their operations.

Attempting to differentiate between companies limited by guarantee based on the nature of their operations both provides opportunity for abuse and manipulation, and the unintended consequences of companies that need to report no longer being required to do so. There is no common denominator for determining the nature of operations of companies limited by guarantee.

While companies raising funds through donations from the public may warrant greater transparency, such operations can still be accounted for under the size test. CSA believes that it would be impossible to draft legislation that would consistently and accurately define the nature of operations that would accommodate different purposes, without creating unintended consequences.

[2] ibid

CSA strongly supports audits, as our members believe that audits ensure that companies remain transparent and accountable to all stakeholders. However, it is not appropriate to ask smaller NFPs to undertake a full audit, as this would represent an onerous compliance burden.

On this basis, CSA believes that:

- for companies under the threshold of $1 million in revenue there would be no audit requirement (but such companies would need to provide the minimum standard of disclosure noted above)
- companies with between $1 million and $25 million in revenue would be subject to an audit review (see below)
- companies with revenue over $25 million would be subject to a full audit.

An audit review would not provide an opinion, but would review the financial statements and internal controls, that is, those areas of risk in a company.

Recommendation 3: Use size to determine differential financial reporting obligations

CSA recommends that two threshold tests of $1 million in revenue *and* $1 million in assets be used to determine the applicability of financial reporting requirements for NFPs.

CSA recommends that for companies under the threshold of $1 million there would be no audit requirement.

CSA recommends that companies with between $1 million and $25 million in revenue be subject to an audit review.

CSA recommends that companies with revenue over $25 million would be subject to a full audit.

CSA recommends that NFPs *not* be differentiated by the nature of their operations rather than by size.

4 Need for specific NFP accounting standard

The accounting standards are designed to ensure that investors can analyse financial reports to assess the deployment of and return on their investment. The purpose of the International Financial Reporting Standards is to standardise accounting across jurisdictions, to ease both reporting for companies operating across jurisdictions and the analysis of financial reports in different accounting jurisdictions.

However, NFPs companies are not generally international companies. The international accounting standards have been developed for listed companies operating in capital markets and are not applicable to NFPs and bring no benefits to the NFPs or their stakeholders.

CSA believes that a separate not-for-profit accounting standard should be developed for Australia by the Australian Accounting Standards Board (AASB) to reflect specific not-for-profit disclosure.

CSA believes that NFPs should continue to have the choice to report under the International Financial Reporting Standards (IFRS), even after the introduction of a specific NFP accounting standard. As noted earlier, many NFPs, particularly larger ones, choose to produce full reports for reasons related to the desire to be transparent and accountable.

CSA also notes that, regardless of the amount of financial information NFP companies should be obliged to report, there should be an obligation on the directors to prepare financial statements that are meaningful and do not omit material information.

CSA notes that the Centre for Philanthropy and NonProfit Studies at Queensland University of Technology has already developed a standard charter of accounts that could inform such a new dedicated NFP accounting standard.

CSA also notes that there have been several calls for an NFP sector-specific accounting standard (for example, the 1995 Industry Commission Report on Charitable Organisations in Australia, the 2001 Charity Definition Inquiry Report, and the 2006 Institute of Chartered Accountants of Australia report on not-for-profit sector reporting).

Finally, CSA also notes that many of the issues raised in the *Choice* article cited by the Background Paper could be addressed by consistent disclosure requirements in a tailor-made accounting standard for NFPs.

Recommendation 4: Develop a specific NFP accounting standard

CSA recommends that a separate not-for-profit accounting standard should be developed for Australia by the AASB.

CSA recommends that such a NFP accounting standard include segment analysis.

CSA also recommends that NFPs be granted the choice to report under IFRS even after the introduction of a dedicated NFP accounting standard.

5 Need for dedicated regulatory oversight

CSA supports ASIC continuing to regulate NFP companies in the short term, but notes that at present it has no expertise in this sector. The Woodward Report identified that there is dissatisfaction with ASIC's performance as a regulator of NFP companies, with the majority of respondents seeing ASIC's regulation of the Corporations Act being more appropriate for 'for-profit' companies than NFP ones.

CSA recommends on p 12 that a specialist regulator be introduced for the NFP sector. However, CSA recommends that, in the interim, regulation of the NFP sector rest with ASIC. In order to ensure that ASIC is able to regulate NFP companies in the short term, ASIC needs to develop NFP expertise, including the capacity to provide assistance to NFP companies struggling to understand their compliance obligations. It would be useful for ASIC to:

- establish a specialist unit within ASIC to deal with NFP companies, with further training for ASIC officers about the particular needs of NFP company stakeholders
- a plain-language guide for NFP companies.

CSA believes that it would be very important for ASIC to undertake not only a compliance and enforcement role, but also an educational role in regards to the NFP sector.

CSA notes that national regulation of will also provide the added benefit of the collection of ongoing data on the sector based on NFP registration. At present, it is difficult to collate data on the sector, to assess its growth as well as its extent.

ASIC is currently in the process of upgrading its technology, which should facilitate its taking on the great number of NFP organisations currently regulated under State-based legislation. The process for rolling out ASIC's new database could coincide with any movement to a single regulatory regime, so that the technology upgrade could take account of such issues as:

- a vast increase in the number of companies regulated by ASIC
- the capacity for ASIC to provide a simple online form for NFPs to fill out to facilitate their provision of a short-form governance disclosure, as recommended earlier
- the capacity for anyone to search for the short-form disclosure of each and any NFP organisation in Australia, *at no charge*, so that information on the sector is available to all stakeholders. This would greatly assist in enhancing the transparency of the sector.

Recommendation 5: Establish NFP expertise in ASIC

CSA recommends that ASIC be the regulator of NFP companies in the short term.

CSA recommends that a specialist unit be established in ASIC to deal with NFP companies and to develop a plain-English guide for such companies.

CSA also recommends that ASIC provide a simple online form for NFPs to fill out to facilitate their provision of a short-form governance disclosure.

CSA also recommends that the short-form governance disclosures made by NFPs be available to be searched on the ASIC database, free of charge, at any time, so that information on the sector is available to all stakeholders.

6 Need for harmonisation of reporting requirements from government grantors

NFP organisations that receive grants need to report to the funding body or grantor against a set of conditions attached to the grant. The NFPs usually need to show that they have fulfilled the conditions of the grant, or achieved a set of key performance indicators upon which the grant rests.

There can be disquiet within NFPs, particularly within the benevolent NFPs, at the level of expense incurred in administration functions in the financial recording and reporting functions attached to the receipt of government or other donor grants. The more diverse and numerous the sources of funding, the greater is the amount of work required to account to donors and benefactors for the expenditure of those funds. This is not always a simple task and is generally very time-consuming. The employment of competent financial staff can be a considerable organisational cost. The cost of computer-based accounting systems must also be considered. It is usual that, where adequate accountability is not provided to the donors/benefactors, then those funds would need to be repaid. This is the case in most circumstances with government grants. Failure to report correctly can see not only a request for repayment but also discontinuance of future funding.

However, CSA notes that each government department currently has different reporting requirements. This introduces an extraordinary level of complexity into the disclosure regime of NFPs, particularly charities. Such complexity does not assist either the delivery of services, given the allocation of scarce resources to fulfilling reporting obligations, or stakeholder information needs, as comparability is ineffective.

CSA notes that even if the requirements under the Corporations Act are simplified to provide for the filing of more appropriate information by small NFPs, with full accounts lodged by larger NFPs, this reform will be effectively negated if the government funding agreements at both the State and Commonwealth level are not also simplified and made consistent. The current lack of consistency places an onerous financial reporting obligation on NFPs.

CSA suggests that Treasury could facilitate harmonisation on this front with other government departments.

Recommendation 6: Introduce consistency of reporting requirements for government funding agreements

CSA recommends that reporting requirements for government funding agreements to NFPs are harmonised across government departments.

2 Models of regulation and legal forms that would improve governance and management of charities and not-for-profit organisations and cater for emerging social enterprises

ASIC regulates approximately 1.65 million companies. The total number of proprietary companies is 1,628,000 and the total number of public companies is 20,800. Of the public companies, there are:

- approximately 11,000 companies limited by guarantee (eg, professional associations, clubs)
- approximately 7,000 unlisted public companies limited by shares (eg, commercial businesses)
- 122 companies limited by shares and guarantee (eg, private schools)
- 14 unlimited (professional practice)
- 334 no liability (eg, mining companies)[3]
- 2,090 listed public companies.[4]

The survey of NFPs that led to the Woodward Report was sent to all companies limited by guarantee on ASIC's website as of 1 March 2002. These companies were sent a survey and over 1,700 replies were received. Virtually all (98 per cent) of respondents were NFPs, confirming that the company limited by guarantee structure is used exclusively by NFPs.

The report noted that there are various reasons as to why a company limited by guarantee is chosen as the legal structure of preference, rather than, for example, an incorporated association or a proprietary company.

The choice of the structure of company limited by guarantee was based on the following:

- Over a third (34 per cent) indicated that being a 'national or multi-state organisation' was an important factor in their choice of a company structure.
- Forty per cent indicated that the 'scale of trading activities' was an important factor, which is an area of debate and variation in the associations' regime.
- Almost a third (31 per cent) identified a preference for ASIC 'rather than State regulator' as an important factor, supporting anecdotal evidence that many of the State regulators are under-resourced and cannot cope easily with organisations that want to have variations to the prescribed model rules.
- 'Public perception and status' was important to the majority (52 per cent). This supports anecdotal evidence that 'serious' or 'more sophisticated' NFP organisations are companies rather than incorporated associations.[5]

The report noted that companies limited by guarantee, with a NFP motivation, are governed by a company law regime designed to meet the needs of 'for-profits'. Dividends, share buy-backs and many other concepts have no relevance to the officers and members of a NFP organisation. It queried whether a new NFP company structure is required under the Corporations Act and whether it was time to introduce a specialist form of company structure instead of or in addition to incorporated associations legislation.

Appendix B sets out the definition of a company limited by guarantee.

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[3] All figures relating to companies limited by guarantee, by shares and guarantee, unlimited and no liability are from ASIC as of 2008

[4] *ASX Annual Report 2007;* figures as at 30 June 2007

[5] Woodward S, 'Not-for-profit organisations: do they fit the company mould?', *Keeping good companies* Vol 55 No 5, 2003, p 278, Chartered Secretaries Australia

Future NFP legal structures

There is a myriad of legal structures under which NFP organisations currently operate (incorporated association, company limited by guarantee, proprietary company, trust, cooperatives, Royal Charter, special Act of Parliament, aboriginal corporations). This introduces confusion as to compliance obligations, inefficiencies in regulatory compliance, considerable duplication and does not assist the central objective of ensuring that the legal form supports the objects of the organisation.

The United Kingdom has introduced a regulatory framework specific to the NFP sector. CSA believes that the Australian Government should examine the work undertaken in the United Kingdom and the framework it has implemented to assess if a similar framework should be implemented in Australia.

Earlier, CSA noted that a national regulatory regime should be implemented. Such a regime would in turn provide for a review of the existing legal structures used by NFP organisations, and this could lead to the introduction of a single, specialist NFP legal structure. Any new structure should meet the needs of both small and large NFP organisations. It is also important that any conversion from existing legal structures to a new legal structure should be as simple as possible and should not impose costs on NFPs.

Once a specialist NFP legal structure had been introduced, it would be important to provide a specialist regulator for the NFP sector.

The expertise developed in ASIC could form the nucleus of such a regulator.

CSA points to the UK Charity Commission as one possible model for such a specialist regulator. CSA also believes that it is important that the national specialist regulator should determine if a NFP company attracts charity status. CSA believes that the Australian Taxation Office should not be determining whether a NFP company should attract charity status.

Recommendation 7: Introduce a single, specialist NFP legal structure and regulator

CSA recommends that the Federal Government work with the State Governments to introduce a single, specialist NFP legal structure.

CSA recommends that a specialist NFP regulator be established.

Appendix A: Difference between private and public company structure under the Corporations Act

(1) Types of companies

Public vs private	Type of company	Differences in regulation	Regulated by	Percentage of registrations
Proprietary = private Must have at least one member and up to a maximum of 50 non-employee shareholders By definition UNLISTED, as they are not allowed to raise capital that would require lodging a prospectus or offer information statement Can hold shares in listed companies Can offer shares to existing shareholders of the company or employees of the company or a subsidiary of the company	- Limited by shares - Unlimited with share capital Can be any size; some are very large Compliance requirements less stringent than for public companies	Sub-classified as small or large **Small =** - consolidated gross operating revenue < $25m - consolidated gross asset value < $12.5m - fewer than 50 f/t employees **Large =** revenue, assets and employees greater than small companies Proprietary companies must have at least one director and need not have a company secretary	ASIC	The majority of registered companies are proprietary. As at 2008, there were 1,628,000 proprietary companies, representing 98.7% of all registered companies.

Public = Ltd Minimum of one member, but there is no maximum Can be LISTED or UNLISTED The use of 'Ltd' does not distinguish between them Can own Pty Ltd companies Public Unlisted and Listed Companies can raise capital by offering a prospectus – reporting to ASIC	- Limited by shares, eg commercial businesses - Limited by guarantee e.g. charities, not-for-profits, clubs Limited by both shares and guarantee, eg private schools, friendly societies - Unlimited, eg professional practices - No liability (NL) – only for mining companies	A public company must have at least three directors and at least one company secretary.	*Unlisted* – ASIC APRA, if an authorised deposit-taking institution, life insurance or general insurance company *Listed* – ASIC ASX APRA, if an authorised deposit-taking institution, life insurance or general insurance company	As at 2008, there were 20,800 public companies. Of these, 2,090 were listed. From 1 July 1998 it has not been possible to register a company limited by shares and guarantee, but the existing 122 companies of this type are allowed to continue.

(2) Differences in disclosure requirements

	Small proprietary companies	**Large proprietary companies**	**Public companies**	**Listed public companies**
Audit and financial reports	Not required to be audited or file financial statements or a directors' report. Members holding five per cent or more of the votes, or ASIC, can require a financial and directors' report for a financial year (and direct them to be audited) and send them to	Required to have an external audit and will have to lodge financial statements and a directors' report	Required to have an external audit and will have to lodge financial statements and a directors' report	Required to have an external audit and will have to lodge financial statements, a directors' report and a remuneration report

	all shareholders			
Reporting to members	No requirement to report to members	Required to provide reports to members four months after the end of the company's financial year	Required to provide reports to members 21 days prior to the AGM or four months after the end of the company's financial year, whichever is earlier	Required to lodge accounts with ASIC three months after the end of the company's financial year
Holding an AGM	No obligation to hold an AGM unless the constitution requires it	No obligation to hold an AGM unless the constitution requires it	Must hold an AGM once a year no later than five months after the end of the company's financial year	Must hold an AGM once a year no later than five months after the end of the company's financial year. A minimum of 28 days' notice of the AGM must be provided.
Disclosure of constitution	No requirement to lodge a copy of the constitution	No requirement to lodge a copy of the constitution	Required to lodge a copy of the special resolution adopting, modifying or repealing its constitution, and if adopted, a copy of the constitution, and if modified, a copy of that modification.	Required to lodge a copy of the special resolution adopting, modifying or repealing its constitution, and if adopted, a copy of the constitution, and if modified, a copy of that modification.
Directors voting on matters where there is a personal material interest being considered at a director's meeting	Can vote	Can vote	Must not be present while the matter is being considered at the meeting or vote on the matter, unless the other directors are satisfied that the interest should not disqualify the director from voting.	Must not be present while the matter is being considered at the meeting or vote on the matter, unless the other directors are satisfied that the interest should not disqualify the director from voting.

Removal of directors			Cannot be removed by other directors but are subject to removal by the members.	Cannot be removed by other directors but are subject to removal by the members.
Liability of directors for insolvent trading	Face personal liability if the company should carry on trading while insolvent if they cannot establish adequate defences	Face personal liability if the company should carry on trading while insolvent if they cannot establish adequate defences	Face personal liability if the company should carry on trading while insolvent if they cannot establish adequate defences	Face personal liability if the company should carry on trading while insolvent if they cannot establish adequate defences
Directors to notify market operator of interests				Required to notify their interest in the securities of the company of which they are a director and any changes to those interests.
Questions to the auditor				Members are entitled to submit questions to the auditor prior to the AGM and the auditor is obliged to attend or be represented at the AGM.

Appendix B: Definitions of a company limited by guarantee and not-for-profit

Section 9 of the Corporations Act defines a company limited by guarantee to mean:

> a company formed on the principle of having the liability of its members limited to the respective amounts that the members undertake to contribute to the property of the company if it is wound up.

Often this sum is nominal only. A member incurs no further liability (known as limited liability) unless the constitution expressly expands their liability (which is rare) or they are exposed to liability in some capacity, such as by acting as a director.

A company limited by guarantee is a public company (as opposed to a private or proprietary company). It has members rather than shareholders, although it is able to issue debentures. If it has been granted tax-exempt status by the ATO, then it must not confer 'private benefits' (that is, distribute any profits it generates) on its members, directors or other persons or entities other than to further the charitable or tax-exempt objects of the company.

The ATO sets out those purposes that it does not consider are charitable because they are not for the benefit of the public. These purposes include the following:

- purposes of gain or profit for private persons
- promoting the common interests of persons in their private capacities
- providing mutual benefits for persons in their private capacities
- conferring benefits on persons in their private capacities.

This prohibition does not prevent the company remunerating persons for services actually rendered, for example, for secretarial or managerial services, but the rendering of such services must be undertaken strictly in accordance with the terms of its constitution, the terms of which have been pre-approved by the ATO. The Tax Office accepts an organisation as non-profit where its constituent or governing documents prevent it from distributing profits or assets for the benefit of particular people – both while it is operating and when it winds up. These documents should contain acceptable clauses showing the organisation's non-profit character. The organisation's actions must be consistent with this requirement.

The situation is the same for organisations registered under the States' Associations Incorporation Acts. The only exception is that members do not undertake to contribute to the assets in the event of a winding-up.

Often in the constitution, the board of a company limited by guarantee will be called the management committee, executive committee or council. Notwithstanding this terminology, persons on such committees, if they have been appointed or elected as directors or are acting as directors, will be regarded at law as directors with all of the resultant applicable duties and obligations of directors of a public company.

The ATO *Income tax guide for non-profit organisations* contains a checklist to assist organisations to deduce if they are charities.

APPENDIX C

CSA 2007 submission to Treasury on financial reporting by unlisted public companies

3 August 2007

Geoff Miller
General Manager
Corporations and Financial Services Division
Department of the Treasury
Langton Crescent
PARKES ACT 2600

By email: UPCcomments@treasury.gov.au

Dear Mr Miller

Financial reporting by public unlisted companies

CSA is the peak professional body delivering accredited education and the most practical and authoritative training and information on governance, as well as thought leadership in the field. Our members are all involved in governance, corporate administration and compliance with the *Corporations Act* (the Act). Many of our members work for public unlisted companies, or serve as officers of not-for-profit organisations, or manage the affairs of subsidiary companies of public listed companies, which are frequently public unlisted companies. We have drawn on their experience in the formulation of each submission on the matters contained in the Consultation Paper.

General comments

CSA welcomes the discussion paper *Financial Reporting by Public Unlisted Companies* and its focus on ameliorating the regulatory burden, particularly on smaller public unlisted companies and those in the not-for-profit sector. CSA fully supports the proposal to introduce threshold tests to determine which public unlisted companies should be subject to full reporting requirements and which companies could be exempt from such requirements.

CSA also notes that the essence of good governance is accountability, transparency and stewardship, and that any reform of the financial reporting framework for public unlisted companies must balance the reasonableness of compliance requirements, particularly for smaller companies, with the need to ensure that stakeholders continue to have confidence in the governance of such companies.

On this basis, CSA does *not* support the proposed Australian Accounting Standards Board (AASB) small and medium entity (SME) standard, which CSA believes will impose a significant and expensive regulatory burden on small public unlisted companies for no benefit to stakeholders and at great unnecessary expense.

CSA recommends that thresholds be introduced for public unlisted companies in relation to financial reporting requirements (see below) but **rejects** the proposed AASB SME standard as the basis for such a regime.

CSA also opposes the elimination of the 'reporting entity' approach to determining the application of accounting standards. In the absence of any evidence of abuse or problem with the 'reporting entity' concept, CSA queries why the AASB promotes its removal.

CSA also notes that the discussion paper does not discuss one group of companies that are both companies limited by guarantee and companies limited by shares. CSA notes that such companies, while perhaps few in number, nonetheless need to be considered in any process of reform. Most recently this group would include financial organisations, which came under the jurisdiction of the corporations law in 1999. The group of companies that were both limited by guarantee and shares (for example, friendly societies) took the once-off opportunity to elect this form of incorporation in order to provide them with the option, at a later date, of undertaking a process of demutualisation with diminished difficulty.

Proposed AASB SME standard

CSA notes with concern that the discussion paper refers to the differential reporting regime proposed by the AASB, which proposal would negate the impetus to provide relief to smaller public unlisted companies and those in the not-for-profit sector as outlined in Treasury's discussion paper.

Under the proposed AASB revised differential reporting regime, the application of AASB standards would no longer depend on whether entities are reporting entities; rather the focus of application would be general purpose financial reports. Accordingly, all entities that prepare general purpose financial reports would apply either the Australian equivalents to IFRSs or an Australian equivalent to the IFRS for SMEs, based on criteria that establish which set of these standards would apply.

The revised differential reporting regime proposed by the AASB would replace the 'reporting entity' approach to determining the application of accounting standards. Currently almost all not-for-profit companies can select not to be reporting entities and therefore need only produce 'special purpose accounts'. CSA notes that many not-for-profit companies, particularly larger ones, choose to produce full accounts for a variety of reasons beyond the scope of this submission. The important issue is that not-for-profit companies currently have a choice to select 'special purpose accounts', which choice brings with it a significantly reduced reporting requirement and consequential potential for savings.

The new SME standard proposed by the AASB will force all small not-for-profit companies to comply with the new SME reporting standard, which carries considerably greater reporting requirements than the current 'special purpose accounts'. As a result, small not-for-profit companies will incur significantly greater costs in order to produce financial reports, for no benefit to their stakeholders. Members of not-for-profit companies, as noted by the discussion paper, are not investors seeking to examine the accounts to ascertain the deployment of and return on their investment.

CSA is also concerned that any acceptance of the SME standard proposed by the AASB has the capacity to change the current reporting requirements of small proprietary companies. The *Corporations Legislation Amendment (Simpler Regulatory System) Act 2007*, enacted in June 2007, defines a proprietary company as large if it satisfies two of the following tests: revenue of $25 million; assets of $12.5 million and 50 employees, with future changes to thresholds

prescribed by regulations. Those companies that do not meet two of these three threshold tests are classified as small proprietary companies and are exempt from statutory financial reporting.

The introduction of the proposed SME standard could alter this situation and impose a regulatory burden on small proprietary companies. The AASB Exposure Draft says that:

> "the proposals would not affect small proprietary companies. However, if they prepare and lodge financial reports (such as when the ASIC directs them or they are controlled by a foreign company, or 5% of shareholders require them), they would be required to apply an Australian equivalent to the IFRS for SMEs; and large proprietary companies would apply the Australian equivalents to IFRSs if they exceed either of the nominated size thresholds for important for-profit entities, or an Australian equivalent to the IFRS for SMEs if they fall below those thresholds, because they produce general purpose financial reports as a result of having to lodge their financial reports on a public register."

Connected to this potential regulatory imposition is the fact that, at present, large proprietary companies have the option of producing 'special purpose accounts'. The AASB proposals could force all large proprietary companies to produce full financial reports, as a large public listed company may have a number of subsidiaries, of which a certain number could be large proprietary companies. Such an outcome would negate the recent reform of financial reporting for proprietary companies.

A further consequence of accepting the AASB standards as laid out in the *Exposure Draft A Proposed Revised Differential Reporting Regime for Australia and IASB* is that a public company may have subsidiaries that are also public companies. As subsidiaries, the public companies currently only need to produce 'special purpose accounts'. The proposed new standard will force such companies to produce full financial accounts.

CSA is strongly opposed to the proposed AASB standard, which would impose financial reporting requirements on proprietary, public unlisted and not-for-profit companies, for no benefit to stakeholders and at great unnecessary expense.

A Do you support the introduction of a differential reporting regime based on size for companies limited by guarantee? If so, what do you consider to be the appropriate criteria (both in terms of the indicators of size and the quantum of those indicators) for differentiating between those companies that are required to report and those companies that are exempt?

CSA agrees that many companies limited by guarantee are small not-for-profit organisations operating for the benefit of members (for example, small sporting clubs), and that, for such companies, the requirement to apply the same reporting and auditing regime that applies to public listed companies imposes a severe regulatory burden. The members of such companies want to know the financial position of the company and that the company is being managed well, but the current full level of statutory reporting does not fulfil this need. Members rely on internal reports to gain an understanding of the financial position of the company. The reporting requirements under the Corporations Act are onerous for companies limited by guarantee, yet do not provide member benefit.

CSA believes that financial reporting requirements for companies limited by guarantee should be based on size. Such a differential reporting regime currently operates for proprietary companies. A proprietary company must meet two out of three thresholds in order to gain relief from financial reporting requirements. CSA believes that this differential reporting regime for proprietary companies, based on threshold tests concerning revenue, assets and employee

numbers, works well. However, CSA does not believe that the same threshold tests can be applied to public unlisted companies.

CSA recommends that threshold tests of $1 million in revenue and $1 million in assets be used to determine the applicability of financial reporting requirements to companies limited by guarantee. CSA further suggests an added threshold test to protect charities that may possess small classes of assets that may have been donated to them. Thus, if a company limited by guarantee meets both threshold tests, they are captured automatically in the financial reporting requirements. If a company limited by guarantee meets one out of the two threshold tests (for example, less than $1 million in revenue but $1.8 million in assets) then the second threshold test rises to $2 million before the automatic capture of the company in financial reporting requirements. CSA notes that, according to the discussion paper, the use of $1 million in revenue as a threshold provides relief to 68 per cent of companies limited by guarantee. All companies limited by guarantee that do not meet these threshold tests would be automatically exempted from statutory financial reporting. CSA agrees that employee numbers should not be used as a threshold test, due to the prevalence of volunteer labour in the not-for-profit sector.

CSA also recommends that a specialised accounting standard be introduced for not-for-profit companies limited by guarantee with revenue between $1 million and $25 million. Such companies would also be subject to an audit review rather than a full audit (see below).

CSA recommends that all companies limited by guarantee with revenue over $25 million be subject to full financial reporting requirements.

CSA strongly recommends that the reporting entity concept be retained and that not-for-profit companies, both large and small, continue to be able to produce special purpose accounts. CSA is strongly opposed to the use of the AASB proposal for a SME standard as the base of a differential reporting regime, which would remove the current special purpose financial reports. CSA believes that the proposed SME standard will negate the intention, as laid out in the discussion paper, to provide relief for small not-for-profit companies.

Finally, CSA notes that companies that are either exempt under this proposal from financial reporting requirements or captured by a purpose-built not-for-profit accounting standard may have statutory reporting obligations under other legislation, such as the Charitable Fundraising Act 1991 (NSW) and that these would remain unchanged.

B Do you believe that it is appropriate to differentiate between companies limited by guarantee by the nature of their operations rather than just size? If so, what nature of operations do you believe warrants greater transparency?

As noted above, CSA supports the introduction of a differential reporting regime based on size, which is an objective measurement when based on revenue, assets and employee numbers. Such a differential reporting regime would need to be based on the current definitions of 'reporting entity' and 'special purpose financial reports' and *not* on the SME standard proposed by the AASB.

However, CSA does not support differentiating between companies limited by guarantee based on the nature of their operations.

Attempting to differentiate between companies limited by guarantee based on the nature of their operations both provides opportunity for abuse and manipulation, and the unintended consequences of companies that need to report no longer being required to do so. There is no common denominator for determining the nature of operations of companies limited by guarantee.

While companies raising funds through donations from the public may warrant greater transparency, such operations can still be accounted for under the size test. CSA believes that it would be impossible to draft legislation that would consistently and accurately define the nature of operations that would accommodate different purposes, without creating unintended consequences.

CSA recommends that companies limited by guarantee *not* be differentiated by the nature of their operations rather than just by size.

C Do you consider that companies limited by guarantee that receive any money through grants should have financial reporting requirements? If so, can this obligation be satisfied by the company providing special purpose financial reports to the grantor rather than preparing general purpose financial reports under the Corporations Act?

Companies limited by guarantee that receive grants need to report to the funding body or grantor against a set of conditions attached to the grant. The companies usually need to show that they have fulfilled the conditions of the grant, or achieve a set of key performance indicators upon which the grant rests. To require companies limited by guarantee to prepare general purpose financial reports under the Corporations Act as well as to report against a set of conditions attached to the grant would simply impose a new level of regulatory burden on companies limited by guarantee. Such general purpose financial reports under the Corporations Act would not assist companies limited by guarantee in reporting against the conditions attached to their grants.

CSA recommends that any financial reporting obligations to funding bodies or grantors for money received through grants by companies limited by guarantee be satisfied by the company providing financial reports and agreed information to the grantor and *not* by preparing general purpose financial reports under the Corporations Act.

D If you support some companies limited by guarantee being exempted from financial reporting, what percentage of members should be required in order to require an exempt company limited by guarantee to prepare a financial report?

CSA recommends that an exempt company limited by guarantee should be required to prepare financial reports in accordance with the Corporations Act if the lesser of 100 members or five per cent of voting members requests it to do so.

CSA notes that this requirement could be based on s 293 of the Corporations Act, which allows shareholders to nominate the information they would like to receive and whether the information is to be audited.

CSA also recommends that ASIC be able to request a company limited by guarantee to prepare financial reports.

E If you support the retention of financial reporting requirements for all companies limited by guarantee, do you consider that there is scope to reduce the amount of financial information these companies are required to report? If so, what type of financial information do users need companies limited by guarantee to report (for example, related-party disclosures)?

CSA *does not* support the retention of financial reporting requirements for all companies limited by guarantee.

CSA supports the principle of a SME standard being introduced that will assist to reduce the amount of financial information that a smaller company limited by guarantee would be required to report. However, CSA does not support the proposed AASB SME standard. This standard has been developed for listed companies operating in capital markets and is not applicable to companies limited by guarantee, many of which are not-for-profit.

The purpose of IFRS, including the proposed SME standard, is to standardise accounting across jurisdictions, both to ease reporting for companies operating across jurisdictions and the analysis of financial reports in different accounting jurisdictions. However, not-for-profit companies are not international companies. The introduction of a standard international reporting framework for the not-for-profit sector would considerably increase the cost of preparing financial statements for smaller companies without any significant benefit to the companies or their stakeholders.

CSA suggests that a separate not-for-profit disclosure standard should be developed for Australia by the AASB and the current AASB SME standard be modified to reflect specific not-for-profit disclosure. Large not-for-profit companies limited by guarantee could utilise this yet-to-be-modified SME standard regardless of size. CSA notes that, regardless of the amount of financial information companies limited by guarantee should be obliged to report, there should be an obligation on the directors to prepare financial statements that are meaningful and do not omit material information.

CSA recommends that the current reporting of special purpose accounts is sufficient disclosure for not-for-profit companies. The stakeholders of companies limited by guarantee should be determining whether general purpose or special purpose financial reports are required.

CSA also recommends that related-party disclosures *must* be included in any financial information companies limited by guarantee are required to report.

F Do you consider that there is a need to harmonise the financial reporting requirements of companies limited by guarantee and incorporated associations to provide a consistent reporting framework for not-for-profit entities in Australia?

CSA recommends that consistent standard for reporting obligations apply across the Corporations Act and the state-based legislation for unincorporated associations. Every company, no matter where it is registered in Australia, should apply the same rules and every not-for-profit organisation should be treated in the same manner.

G In order to assist in progressing this project, it would be useful to obtain an indication from companies limited by guarantee of the cost of preparing a directors' report and audited financial report as required by the Corporations Act.

CSA believes that the amount quoted in the Simpler Regulatory System Bill (Chapter 9 of the Explanatory Memorandum) of around $60,000 for a large proprietary company would be a reasonable indicator of the cost for a company limited by guarantee to produce a financial report. CSA also believes that such reports would cost considerably more if prepared on an

IFRS for SMEs basis (that is, as a general purpose financial report). CSA believes an additional cost of $40,000 could be involved for small companies limited by guarantee, as applying this standard would mean that companies would need to produce additional information. The additional costs would arise as a result of the need to:

- use external accountants
- increase the level of audit
- increase the production costs associated with the annual report.

CSA notes that many smaller companies limited by guarantee would not have the employee resources to prepare financial reports as required under the Corporations Act and would therefore have to outsource such reporting. All costs associated with preparing financial reports, such as printing, mailing, auditing and the human resource costs of accounting, administration and publishing, would affect the bottom line for smaller companies,.

Audit requirements

H If some companies limited by guarantee were to be exempt from financial reporting, do you consider there is value in these companies continuing to be subject to some level of non-statutory external assurance as a means of promoting good governance? If so, what should this assurance relate to and how do you think this regime should be introduced (for example, through best practice guidelines issued by the professional accounting bodies)?

CSA recommends that threshold tests of $1 million in revenue and $1 million in assets be used to determine the applicability of financial reporting requirements to companies limited by guarantee.

On this basis, CSA recommends that:

- for companies under the threshold of $1 million in revenue and it would be left to the stakeholders to determine the type of reporting and assurance required
- companies with between $1 million and $25 million in revenue would be subject to an audit review (see below)
- companies with revenue over $25 million would be subject to a full audit.

An audit review would not provide an opinion, but would review the financial statements and internal controls, that is, those areas of risk in a company.

CSA recommends the introduction of an audit review for companies with revenue between $1 million and $25 million.

I For those companies limited by guarantee that are required to prepare financial statements, do you consider that there is a need to change the current audit requirements? If so, which aspects of the current requirements need to be reformed?

CSA strongly supports audits, as our members believe that audits ensure that companies remain transparent and accountable to all stakeholders.

CSA recommends that threshold tests of $1 million in revenue and $1 million in assets be used to determine the applicability of financial reporting requirements to companies limited by guarantee.

On this basis, CSA recommends that:

- for companies under the threshold of $1 million in revenue and it would be left to the stakeholders to determine the type of reporting and assurance required
- companies with between $1 million and $25 million in revenue would be subject to an audit review (see below)
- companies with revenue over $25 million would be subject to a full audit.

An audit review would not provide an opinion, but would review the financial statements and internal controls, that is, those areas of risk in a company.

CSA recommends the introduction of an audit review for companies with revenue between $1 million and $25 million.

J Do you support amending the Corporations Act so that companies limited by guarantee are specifically prohibited from distributing profits to members in the form of dividends?

CSA notes that any such prohibition would pose difficulties for the group of companies that are both companies limited by guarantee and companies limited by shares, which are discussed at the start of this submission.

In the absence of any evidence of abuse or problem, CSA cautions that any legislative reform needs to consider the needs of the group of companies that are both companies limited by guarantee and companies limited by shares.

K Do you support the principle that all for-profit companies that have raised capital from the public should have statutory annual financial reporting obligations?

While companies that are raising money from the public need at the time of fundraising to provide sufficient financial information so that they can attract capital, Table 2 of the Discussion Paper on page 3 clearly indicates that most of the unlisted public companies limited by shares are clearly economically insignificant (44 per cent have revenues of $1 million or less), and few meet the recently amended size threshold revenues and assets tests for large proprietary companies.

CSA does not therefore support the principle that all for-profit companies that have raised capital from the public should have statutory annual financial reporting obligations.

CSA recommends that the same threshold tests as recommended by us for companies limited by guarantee apply to companies limited by shares to determine the applicability of financial reporting requirements, that is, threshold tests of $1 million in revenue and $1 million in assets.

CSA also recommends that five per cent of shareholders in companies exempt from reporting obligations have the right to require the company to prepare financial reports, and can nominate the information they would like to receive and whether the information is to be audited.

L Given a satisfactory mechanism to allow unlisted public companies limited by shares with a not-for-profit objective to convert to a company limited by guarantee is not available, would you support an equivalent differential reporting regime to that proposed for companies limited by guarantee to be established for unlisted public companies limited by shares with a not-for-profit focus? If so, do you support using the definition of not-for-profit entity in the accounting standards to determine whether a company has a not-for-profit focus?

CSA recommends that the same threshold tests as recommended by us for companies limited by guarantee apply for companies limited by shares to determine the applicability of financial reporting requirements, that is, threshold tests of $1 million in revenue and $1 million in assets.

CSA notes that the Accounting Standards definition of not-for-profit classifies a not-for-profit as a company that does not pay tax. CSA points to the fact that mutual organisations pay tax on income they do not earn from members, even though non-member income may be much smaller than member-income. It is important that this fact does not render mutual organisations ineligible for not-for-profit status.

CSA recommends using the definition of not-for-profit entity in the accounting standards to determine whether a company has a not-for-profit focus, regardless of whether the entity is a company limited by guarantee or a company limited by shares. However, CSA points to the accounting standards not-for-profit definition of not paying tax as potentially causing difficulties.

M In order to assist in progressing this project, it would be useful to obtain an indication from unlisted public companies limited by shares of the cost of preparing a directors' report and audited financial report as required by the Corporations Act and also the number of unlisted public companies limited by shares that have a not-for-profit objective.

CSA believes that the amount quoted in the Simpler Regulatory System Bill (Chapter 9 of the Explanatory Memorandum) of around $60,000 for a large proprietary company would be a reasonable indicator of the cost for a company limited by guarantee to produce a financial report. CSA also believes that such reports would cost considerably more if prepared on an IFRS for SMEs basis (that is, as a general purpose financial report). CSA believes an additional cost of $40,000 could be involved for small companies limited by guarantee, as applying this standard would mean that companies would need to produce additional information. The additional costs would arise as a result of the need to:

- use external accountants
- increase the level of audit
- increase the production costs associated with the annual report.

CSA notes that many smaller companies limited by guarantee would not have the employee resources to prepare financial reports as required under the Corporations Act and would therefore have to outsource such reporting. All costs associated with preparing financial reports, such as printing, mailing, auditing and the human resource costs of accounting, administration and publishing, would affect the bottom line for smaller companies.

Conclusion and recommendation

CSA has given careful consideration to the issues raised by the discussion paper on financial reporting by unlisted public companies.

CSA strongly recommends that thresholds be introduced for public unlisted companies in relation to financial reporting requirements, but rejects the proposed AASB SME standard as the basis for such a regime.

CSA also opposes the elimination of the 'reporting entity' approach to determining the application of accounting standards.

CSA would welcome further contact during the consultation process and the opportunity to be involved in further deliberations.

Yours sincerely

Tim Sheehy
CHIEF EXECUTIVE