



25 August 2008

By email: economics.sen@aph.gov.au

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

Dear Sir/Madam

Inquiry into the disclosure regimes for charities and not-for-profit organisations

Thank you for the opportunity to make a submission on these issues.

This Inquiry by the Senate represents an important opportunity to draw together in one report the findings of previous inquiries and research. This earlier work has considered certain sub-sectors of the overall not-for-profit (NFP) sector, or discrete issues (such as the definition of charity).

The Senate Inquiry, therefore, is in a position to draw the key elements and consistent findings of this work together and, mostly importantly to recommend next steps for implementation of a simplified and more coherent, overarching regulatory framework for the whole NFP sector. Such a regulatory environment is necessary to support the highest possible standards of governance and accountability by NFP organisations so their significant economic and social contribution to Australian society can be maximised.

I would like to draw the Inquiry's attention to my previous academic research that is directly on point for the terms of reference, and considers many of the specific questions raised in the Inquiry's Background Paper.

1. WOODWARD & MARSHALL REPORT (2004)

I was the principal researcher and author of '*A Better Framework: reforming not-for-profit regulation*' Susan Woodward & Shelley Marshall, Centre for Corporate Law and Securities Regulation, The University of Melbourne 2004 (freely downloadable see: <http://cclsr.law.unimelb.edu.au/go/centre-activities/research/reforming-not-for-profit-regulation-project/index.cfm>). This Research Report was the result of a 3-year, Australian Research Council funded research project conducted with Philanthropy Australia as an industry partner.

I note the extensive references to my Research Report in Senator Andrew Murray's paper 'One Regulator One System One Law' (July 2006) which forms the basis of his April 2008 paper and is referenced in the Senate Inquiry Background Paper. For ease of reference, I



have included with this submission, the executive summary and summary of recommendations from my Research Report.

2. WOODWARD SUBMISSION TO TREASURY INQUIRY (2007)

On 16 August, 2007 I made a submission to the Treasury Inquiry into the Financial Reporting of Unlisted Public Companies. Again, for ease of reference, I have included a copy of this submission.

3. OTHER OBSERVATIONS

Since completing my Research Report, I have gained considerable experience in the NFP sector in a range of capacities - reviewing projects and governance of a wide range of NFPs via consultancy working for a large philanthropic foundation; continuing my own volunteer membership of two NFP boards; and now working for an NFP. I am currently the Manager of PilchConnect (a specialist legal service of NFP community organisations established in late 2007 by the Public Interest Law Clearing House (Vic) Inc). I remain a Senior Fellow in the Law School at Melbourne University and this year I developed and co-taught a post-graduate subject called 'Governing Not-for-Profit Organisations'.

All of this additional experience has served to further cement the view I formed while conducting my research, that the overall regulatory environment for NFP organisations is fragmented, complex and not well tailored to the needs of the sector and its stakeholders. It is even more complex than for business which, given that the majority of NFPs are small and heavily reliant on volunteers, hinders growth and innovation by the sector, as well as necessary accountability and transparency.

I believe the recommendations made in my Research Report (2004) are still very relevant today. However, since conducting the research I have become more strongly of the opinion that there should be an national, independent, specialist NFP regulator. This is consistent with what has now occurred in NZ.

I have been involved in the submission that is being made by PilchConnect and, rather than repeat points, it is sufficient to say I fully endorse the PilchConnect submission.

I would be pleased to appear at any hearings held by the Senate Inquiry to elaborate or clarify my research, and/or to highlight insights from my NFP experience since conducting that work.

Yours sincerely,



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Senior Fellow

Please note that as I am not currently teaching in the Faculty, the best contact details for me are:

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EXECUTIVE SUMMARY

Context

The not-for-profit (NFP) sector plays a vital role in our society. In economic terms alone:

- ♦ Australians give \$2.8 billion annually to NFP organisations
- ♦ NFPs contribute 4.7% of GDP and account for 6.8% of total employment
- ♦ in comparative terms, NFPs add more to GDP than the mining industry.

The underlying health of the NFP sector is at risk. The regulatory framework that underpins the sector is complex and riddled with inconsistencies. It is time for some preventative medicine. The relevant laws and regulatory bodies need to be fair, consistent and clear in order to promote NFPs that are transparent, accountable and credible. If these fundamentals are 'right', then growth and innovation are more likely to occur.

Currently, there is a myriad of possible legal structures for NFPs – companies, associations, foundations, co-operatives, church auspice, aboriginal corporations, Royal Charter and more. Combined with this is a confusing mix of State and Federal regulation and regulators, and a lack of nationally consistent reporting obligations. These factors provide significant impediments to accountability and could jeopardise donor confidence. Disclosure by NFPs should be directed to the special needs of NFP stakeholders. Regulation should also help entrench a culture of accountability.

While the views of business have been canvassed before any corporate law reforms have been implemented, the views of NFPs have been overlooked. To obtain the views of those involved in a wide range of NFPs, a detailed survey was sent to all of the 9,800 companies limited by guarantee on the public register maintained by ASIC (the Australian Securities and Investments Commission) as at 1 March 2002 (virtually all of which are NFPs). Over 1,700 completed replies were received. The data collected gives, for the first time, a national snap shot of those NFPs that are registered as companies limited by guarantee.

National survey

The survey sought a wide range of information about:

- the organisation's profile - size, principal activity, number of volunteers, member-serving vs public-serving, tax status
- why a company structure had been chosen instead of, say, an incorporated association and whether or not this structure had met the organisation's needs
- who were regarded as the organisation's key stakeholders and what reporting was made to them
- the composition and experience of the Board of Directors – Board size, age, gender and skills, whether fees are paid to non-executive directors, how Board members are chosen, Board independence etc
- the procedures and structures of the Board – what is seen as the organisational role of the Board, frequency and conduct of meetings etc
- whether the current regulatory framework is working – views on what information (if any) should be disclosed to the public, what is the attitude of NFPs to their dealings with ASIC, should there be a new specialist regulator for NFPs.

This Report details the findings of the survey and explores any significant differences between the responses of NFPs based on, for example, their tax status, principal activity or member-serving vs public-serving.

This Report makes several recommendations for reform and identifies some areas for further deliberation. For a summary of these recommendations, together with a summary of some of the supporting findings, see pages 3 -10.

Key findings

- Respondents indicated that they chose a company structure because: it better suits national or multi-state organisations (34% of respondents); the scale of trading activities (40%); a preference for dealing with ASIC rather than State regulators (31%); and public perception or status (52%) (such as the view that 'serious' or 'more sophisticated' NFPs use this structure rather than the incorporated associations' regime). These responses highlight that the State and Territory based incorporated associations regime does not meet the needs of many NFPs, such as peak bodies or small but national organisations.
- On public disclosure, a startling 9% of respondents thought that no information should be made available to the public, while only 39% agreed with fully audited accounts being disclosed (as is

currently required by the Corporations Act), and just over half thought summary financial information should be enough.

- Respondents clearly thought that the Corporations Act and the way it is implemented by ASIC is more appropriate to 'for-profits' than for them. The majority were in favour of a new regulator to oversee NFPs, as recommended by the Charity Definition Inquiry, but concerned to avoid duplication. Better regulation, rather than simply more regulation, is the key.
- NFPs and their needs differ from 'for-profits' in several ways, for example
 - ♦ they rely heavily on volunteers,
 - ♦ they enjoy exemption from income tax
 - ♦ they have more stakeholders to consider (members, volunteers, grant makers etc - not just shareholders interested in 'the bottom line').
- Nearly a third of NFPs reported difficulty recruiting directors and for some types of NFPs, the figure was significantly higher.

Recommendations

The particular needs of the NFP sector have been overlooked in the company law reform process, and the dual State/Federal regime is causing problems. Increasingly, even very small NFPs operate on a national basis, and this is not facilitated by the existing State based incorporated associations' regime. After a decade of a dual regime – companies governed by a national scheme and associations governed by varying State/Territory based legislation – it is time to combine the best elements of each of these with new ideas. 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.

Arising out of the data, key recommendations for regulatory reform include:

- a single Commonwealth regulatory regime (this could be achieved by a referral of powers as recently occurred in the company law model)
- ASIC becoming the new regulator for all incorporated NFPs (companies and associations), at least until a new NFP regulator is introduced
- the establishment of a specialist NFP unit within ASIC
- plain language guide and replaceable rules for NFP organisations.

The survey results also demonstrate a need for additional support services for NFPs. A new independent NFP advisory body should be established to meet this need. A range of support services could be provided at low or no cost – for example, auditing, financial and taxation advice, legal advice, training for Board members, dispute resolution and mediation for stakeholders. This body could make a significant difference, particularly for small NFPs. Such an advisory body would be able to generate at least some of its funding from fees for service.

Recommendations are also made about minimum public disclosure requirements and the need for an NFP-specific accounting standard. Even member-serving organisations that do not receive direct government funding typically get income tax exemption, and therefore have the benefit of public funds through tax foregone. The corresponding responsibility needs to be a minimum level of public disclosure. Additional disclosure requirements should apply to larger NFPs. At the moment there is duplication, and often the disclosure that is required does not meet the needs of NFP stakeholders.

If important reforms are to take place, the sector itself will need to lobby for change, through individual NFPs, through peak organisations, and through bodies such as the newly established National Nonprofit Round Table. By getting the underlying regulatory framework 'right', accountability and confidence in the sector generally will be improved, and NFPs will have more time to concentrate on the important services that they provide to the community.

This Report is available (in colour) on-line at <<http://cclsr.law.unimelb.edu.au/activities/not-for-profit/>>

SUMMARY OF RECOMMENDATIONS

The following are all the recommendations made in the Report and some issues that have been highlighted as requiring further deliberation. There is a cross reference in each recommendation to the relevant Chapter of the Report. The recommendations are grouped under the headings of Regulatory Framework, Legal Structures, Disclosure, Stakeholders and Boards. In order to give some context, there is a brief introduction to each recommendation.

1. REGULATORY FRAMEWORK

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

A single Commonwealth statutory regime should be introduced for all corporate bodies (that is, 'for-profit' companies, NFP companies and incorporated associations) by referrals of power from the States to the Commonwealth, along the lines of what has been achieved for company regulation. Such a referral would enable a national approach to NFP regulation, with responsibility for registration and on-going regulation being conferred on ASIC.

Report Reference: Chapter 4, Regulatory Framework

In terms of who should be the regulator of NFP organisations, the survey identified that there is dissatisfaction with ASIC's performance as a regulator of NFP companies. For example, 54% of respondents believe it is inaccessible to non-business people and 70% of respondents believe that the *Corporations Act* and the way it is implemented by ASIC is more appropriate to 'for-profit' than NFP companies. In view of these (and other) findings, it appears that dissatisfaction with ASIC derives principally from the fact that ASIC is not a specialist NFP regulator.

Recommendation 2: ASIC's role

As long as ASIC continues to regulate companies limited by guarantee, it should take steps to make itself more friendly to NFP users. Such steps might include:

- the establishment of 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 sliding fee structure for NFP companies, based on size
- a plain-language guide for NFP companies.

If ASIC assumes jurisdiction over all incorporated NFP organisations, as recommended in this Report, the need for these steps would be even greater.

Report Reference: Chapter 4, Regulatory Framework

Chapter 4, Regulatory Framework also considers the proposal for a completely new NFP regulator (such as recommended by the Charity Definition Inquiry), and its possible role(s). The Report discusses whether or not providing advice and training, ensuring compliance with regulatory requirements (such as disclosure obligations), determining charitable status (for taxation and other purposes) and providing advocacy on behalf of the NFP sector, should be combined in one body.

In view of feedback from the sector and drawing on experience in the UK, the Report concludes that these roles should not be combined. However, there is a clear need for NFP organisations to be able to draw on specialist, independent advice in a range of areas. This assistance should be provided by a new, independent advisory body, whether or not a new administrative body is established as recommended by the Charity Definition Inquiry. This body would be able to generate at least some of its funding from fees for service. Any shortfall could be met from a combination of funding from philanthropic sources and government.

The establishment of a new, independent advisory body would be of particular benefit to small to medium NFPs and would serve to strengthen the accountability and capacity of the sector.

Recommendation 3: Establish an independent NFP advisory body

An independent NFP advisory body should be established to provide a range of support services for NFP organisations. This would create a centre of expertise in the specialised needs of these organisations. It would also underpin improved accountability and corporate governance practices within the sector. The body should be separate from, and independent of, government and the regulators (including any administrative body established to determine charitable status). The types of services that could be provided at low cost or possibly even 'no cost' to some organisations are:

- auditing
- financial and taxation advice
- legal advice
- training
- dispute resolution and mediation services for NFP stakeholders.

Report Reference: Chapter 4, Regulatory Framework

2. LEGAL STRUCTURES

The related goals of improved accountability and good corporate governance must be supported by the underlying legal structure(s) adopted by NFPs. If the legal structure meets the needs of the organisation, then it will be easier to build consistent and appropriate reporting obligations. In turn, these are the cornerstone of accountability.

There were several interesting findings about why a company limited by guarantee had been chosen as the legal structure. While a significant number were formed at a time when there was effectively no other option (and they have not subsequently chosen to transfer to the incorporated associations' regime), others have chosen the structure because of factors such as public perception and status, the scale of their trading activities and because they are a national or multi-State organisation. While the existing company limited by guarantee legal structure seems to be meeting the overall needs of many NFPs, the structure could be improved within the current regulatory framework.

There is a strong argument for tailoring the nature of what is disclosed and the fees payable to meet the different needs of NFPs.

Recommendation 4: Modify existing Corporations Act requirements

While the existing company limited by guarantee structure has proved satisfactory in the main, some aspects need reform. These include:

- the fee structure should be revised to provide a sliding scale based on size
- information required for disclosure should be tailored to the needs of NFP stakeholders rather than to 'shareholders', and this needs to be supported by an NFP specific accounting standard
- the requirement to lodge audited accounts needs to be reconsidered for small NFP organisations
- a plain-language guide summarising the provisions/obligations relevant to NFP companies (along the lines of the Small Business Guide contained as Part 1.5 of the Corporations Act 2001(Cth)) should be available
- all NFP companies should be required to have an objects clause and the directors should have a duty to pursue those objects
- all NFP companies should be required to have a 'non-distribution' clause
- the remedies available for a breach of the objects clause need to be clarified and strengthened.

Report Reference: Chapter 3, Legal Structure; Chapter 7 Stakeholders

The current myriad of legal structures under which NFP organisations operate (incorporated association, company limited by guarantee, proprietary company, trust, cooperatives, Royal Charter, special Act of Parliament, aboriginal corporations) are confusing and hamper accountability, particularly when combined with the dual Federal/State regime. In Chapter 3, Legal Structure, the Report looks briefly at some interesting reforms in the UK where two new types of company structure are being pursued. Neither the incorporated associations model nor the company limited by guarantee model is entirely satisfactory, especially for smaller, national, membership based organisations.

Recommendation 5: Future NFP legal structures

A national regulatory regime should be implemented. It would be appropriate at that time to reconsider the range of existing legal structures used by NFP organisations. This would be with a view to introducing a single, specialist NFP legal structure. Whilst maintaining some level of choice is desirable,

the current myriad of legal structures leads to confusion and inefficiencies in regulation. Consideration should be given to combining the best aspects of the corporations law and the incorporated associations regimes. The work being done by the UK government would be useful to explore. Any new structure should meet the needs of both small and large NFP organisations, and the issue of converting from existing forms should be addressed in a simple and no-cost way.

Report Reference: Chapter 3, Legal Structure

3. DISCLOSURE

Public disclosure requirements are linked to an organisation's legal structure. The myriad of structures under which NFPs operate has resulted in inconsistencies and significantly disparate disclosure obligations, that are not based on any sound, overall public policy agenda.

Accountability relies on relevant, accurate and up-to-date disclosure. Without accurate information, members and other stakeholders are unable, when necessary, to consider action to constrain the Board or influence the direction of the organisation generally. Perhaps more importantly, if the NFP sector is not seen as accountable, public confidence will be jeopardised and donations put at risk.

The survey data (reported in Chapter 8, Disclosure) shows that the respondents are of the opinion that the current reporting obligations are excessive. This is not, of itself, reason to reduce disclosure. In fact, the Report recommends greater disclosure on some issues such as description of activities, directors' remuneration and related party transactions. However, the key is the nature of the disclosure - what is required to be disclosed and by whom - rather than a blanket call for more information.

The concessional taxation treatment enjoyed by almost all respondents and the reliance on donations from the public, mean that even very small NFPs and those that are primarily member serving, should have a requirement to make some public disclosure. Any disclosure in addition to such a 'minimum requirement' needs to be carefully targeted and proportionate to risk - both to the risk of abuse and also to the risk of damage to public confidence. In general, this means that regulation of small organisations, where the sums of money involved are modest, should be lighter than regulation of large organisations, which handle large sums and may also have a disproportionate impact on public confidence. With this principle in mind, the Report recommends a distinction between large and small NFP companies in determining what ought to be disclosed to ASIC. Small business gained concession several years ago, and it is now time for the NFP sector to demand some attention to their special needs.

Recommendation 6: Reform of Corporations Act disclosure requirements

The current disclosure obligations required by the Corporations Act 2001 (Cth) (in particular the requirement for audited accounts by small NFP companies limited by guarantee) do not achieve the appropriate balance between legitimate public and stakeholder interest in disclosure, on the one hand, and the relative cost to the size of the organisation, on the other. A sliding scale of disclosure requirements based on size should be developed for NFP organisations, and be tailored specifically to the needs of stakeholders. There should be a minimum disclosure standard required of all NFP organisations, regardless of size, and this should include:

- summary or concise financial statement, based on an NFP specific accounting standard
- a description of the activities that have been carried out, and how they meet the objects of the organisation
- disclosure of whether or not directors have received remuneration.

For larger organisations, further information should be supplied. This could include:

- audited accounts
- disclosure of the amount (and possibly sources) of public funding.

Small organisations might be defined as organisations whose annual income or total annual expenditure is less than \$100,000. However, further consideration needs to be given to the criteria for determining size. ASIC, or a certain percentage of members, should have the residual power to require any organisation to be audited.

Report Reference: Chapter 8, Disclosure

There have been several calls for an NFP sector-specific accounting standard (for example, 1995 Industry Commission Report on Charitable Organisations in Australia, 2001 Charity Definition Inquiry Report, and 2003 Chartered Accountants of Australia Review of Not-for-Profit Financial and Annual Reporting).

Interestingly, the majority of survey respondents (56%) were in favour of lodging only 'summary financial information' whereas the current requirement for companies limited by guarantee is for audited accounts. However, if the obligations regarding financial reports were tailored to meet the needs of NFPs, their members, donors and other stakeholders, then a requirement to lodge them under the Corporations Act should not be regarded as too onerous. In any event, the burden on organisations would be justified by the public benefit.

Recommendation 7: Introduce a NFP-specific Accounting Standard

The 1995 Industry Commission's recommendation that the Australian Accounting Standards Board and Public Sector Accounting Standards Board develop suitable accounting standards for NFP organisations, should be implemented. Consideration should be given to elements from which it would be appropriate to exempt small organisations.

Report Reference: Chapter 8, Disclosure

The 1995 Industry Commission Report on Charitable Organisations identified the following problems with the current system of accountability by NFP organisations:

- lack of consistent data collection processes
- lack of public access to information
- lack of standardisation of financial reporting and other information.

Almost a decade later, these are still key issues. It needs to be a proactive, Federal and State 'whole of government' approach and it needs to occur before there is any particular need to 'react'.

Recommendation 8: Review overall NFP disclosure obligations

The survey data demonstrates that a review of the overall reporting obligations for NFP organisations is required. The data shows that current disclosure requirements:

- are not well tailored to the needs of the NFP sector and its stakeholders
- entail considerable duplication
- have an overall load that is too onerous for most small NFP organisations.

The current reporting requirements for fundraising are State-based, irregular and often duplicate the taxation and corporations law requirements. This duplication places an unnecessary administrative burden on NFP organisations, which often rely on volunteer labour. The reporting obligations under various Acts - including the Corporations Act 2001 (Cth) and various State Fundraising and Collection Acts - should be unified. Multiple filings should be avoided and low-cost, online searching facilities should be available so as to maximise transparency. It is desirable that the reporting obligations should, as much as possible, constitute a 'one-stop' report that would satisfy the needs of various bodies.

A review of NFP disclosure requirements should include consultation with the NFP sector and their stakeholders. The review will also need to have regard to the sometimes competing concerns of a range of organisations such as funding bodies, the Australian Taxation Office, State departments administering the Fundraising/Collection Acts and peak accountant bodies, with a view to minimising the current duplication of disclosure obligations.

Report Reference: Chapter 8, Disclosure

There is no standardisation of reports or accounting standards that allows potential or recurrent donors, members or other stakeholders to easily compare similar NFP organisations. This information would also be useful to the NFP organisations themselves, as they examine their management practices and benchmark against other NFPs. Standardised reports would assist policy makers to examine where

Summary of Recommendations

money has been spent and what kinds of programs have been run. This would help them track the kinds of overall effects these programs have had. It would be a useful addition to the current data that is available to (and from) the Australian Bureau of Statistics. It would be an important first step in any longitudinal study of the effectiveness of the programs of NFPs. On the other hand, there are important reasons to be cautious about the introduction of standardised reports and these are discussed in Chapter 8, Disclosure (see headings 5.9.3 and 5.12.3).

Issue for further deliberation: Standard Information Return

Consideration should be given to the desirability of developing a Standard Information Return, similar to the Annual Return proposed by the NZ Working Party on Registration, Reporting and Monitoring of Charities (see Appendix 4).

Consideration should be given to whether organisations should be asked to disclose their main purposes and activities. Matters for disclosure might include the number of years the activity has been carried out, in what geographical areas, and how those activities furthered the objects of the organisation. The Return might also include questions about how accountability to stakeholders is achieved.

Report Reference: Chapter 8, Disclosure

Unlike non-executive directors of 'for-profit' companies, it is not common practice for non-executive directors of NFP organisations to receive remuneration, or other benefits. Only 8% of respondents said that directors were remunerated. Disclosure in the case of directors that are remunerated is important. Stakeholders (members, donors and creditors, in particular) have an obvious interest in knowing if non-executive directors are paid, and if senior management are paid more than the market demands for managers of NFPs. Information about the remuneration of senior management may also be desirable.

The rules regarding disclosure of related party transactions (as contained in Chapter 2E of the Corporations Act 2001 (Cth)) are applied differently to companies limited by guarantee depending upon whether or not they hold a name licence. Those that hold a licence to omit the word 'limited' from their name (a name licence) are not bound to comply with the related party transaction provisions. Those that do not hold a name licence, are subject to the provisions affecting related party transactions. For all companies (name licence, no name licence, limited by guarantee or proprietary), excessive remuneration may constitute oppressive or unfair conduct under Part 2F.1 of the Corporations Act and/or a breach of directors' duties. Inconsistency in the application of the related party transaction provisions does not seem desirable. There does not appear to be any sound policy reason why a sub-group of NFP companies should be exempt from reporting, and gaining member approval, for example when a relative of a director is going to receive a payment that is in excess of what can be regarded as 'reasonable remuneration'. It also seems desirable that organisations should report payments to trustees or Board members of NFPs, by related parties.

Issue for further deliberation: Disclosure of payments to directors

Where directors, trustees or committee members or related parties (that is, relations or associates) receive benefits of any kind (including salaries, fees, honoraria, and in-kind compensation), these should be publicly disclosed. Consideration should be given to the application of Chapter 2E of the Corporations Act 2001 (Cth) (related party transactions), or possibly new conflict of interest type-provisions, to all NFP companies. That is, removing the existing exemption for companies limited by guarantee that hold a licence to omit the word 'limited' from their name. This would be in addition to finding the most effective way of ensuring that all NFP organisations disclose remuneration of directors and officers.

Report Reference: Chapter 8, Disclosure; Chapter 5, Board Size, Composition, Remuneration and Experience

Only 24% of survey respondents thought 'marketing expenditure compared with fundraising receipts' should be disclosed, although there were some interesting variations between respondents based on size and principal activity. There is currently no requirement under the Corporations Act to disclose this information and there is considerable inconsistency between the Fundraising and Collection Acts of the States and Territories. While there does not seem any great degree of support from across the sector to make this information publicly available, it is being increasingly demanded by the public and grant makers. There are, however, a number of problems in attempting to compare fundraising costs. These costs can vary widely, largely due to factors beyond the organisation's control, such as the popularity of the cause.

Issue for further deliberation: Fundraising accounting standards

Further consideration should be given to the way revenue from fundraising, gifts, memberships, dues and association fees, and the sale of goods and services, is disclosed. This is in addition to disclosure of moneys spent on administration, advertising, promotion and the like. This matter requires further consideration by the Australian Accounting Standards Board, as comparability between organisations is a vexed issue. Consideration should be given to including an estimate of the number of volunteer hours donated to the organisation, because the donation of time and labour is an important and unique aspect of the NFP sector.

Report Reference: Chapter 8, Disclosure

4. STAKEHOLDERS

The survey findings showed that, as expected, there are a greater *number* of stakeholders in NFP companies than in 'for-profit' companies. The data also provides some surprising insights into the *types* of stakeholders that those working in NFP organisations identify as their principal stakeholders. Both the number and the type of stakeholders relevant to NFP organisations are (in the words of one respondent) 'alien' to the reporting requirements of the *Corporations Act 2001* (Cth). But there are wider implications. The data on stakeholders highlights a fundamental difference between NFP organisations and 'for-profit' companies. The primary reason that NFP and 'for-profit' stakeholders differ is because the objects or mission of the organisation differ. NFP organisations are generally established with the object or mission of serving the interests of certain stakeholders, whether they are the members of a club or the clients of a welfare organisation. Any consideration of NFP accountability must include an assessment of the extent to which the NFP objects or mission have been met.

It is necessary to provide remedies for members in an NFP organisation as an accountability mechanism so that they can ensure that the organisation continues to pursue its mission. However, a fine balance needs to be achieved. The range of accountability mechanisms are more limited in NFP organisations than in 'for-profit' companies, particularly in large listed companies where additional mechanisms are in force. In contrast, the financial resources of an NFP organisation are often limited. It is not in the public good for these limited resources to be expended defending vexatious legal actions by members. These issues are discussed in Chapter 7, Stakeholders.

Recommendation 9: Reform of members' remedies

The special position of members in NFP companies should be considered further in the context of remedies. Members of NFP organisations do not have the same economic power as members of 'for-profit' companies. Nor do they have recourse to a range of shareholder remedies such as selling their shares. Thus members' ability to constrain the actions of Board members and officers of the company, or to ensure that action is taken following a breach of the constitution, is limited. In addition, one of the unique characteristics of NFP organisations is the range of stakeholders with a legitimate interest in the organisation. The public, donors, clients and volunteers all have special stakes in ensuring that the mission of the NFP organisation is pursued and that the organisation's funds are not distributed to members.

The consequences of a breach of NFP objects should be reconsidered, as their mission is what drives NFP organisations. In this regard we suggest that the following specific reforms be considered:

- All NFP companies should be required to have a 'non-distribution' clause.
- Objects clauses should be compulsory for all NFP companies (not just those holding a licence to omit the word 'limited' from their name).
- The directors should have a specific duty to ensure that the company pursues these objects.
- A breach of the objects clause should be an express ground for bringing an action under s 232 of the *Corporations Act 2001* (Cth) (the oppression remedy) and, possibly, also under s 236 (the statutory derivative action). Modification of s 232 in this way would also enable ASIC to initiate action under s 234 on the basis of a complaint by a member or other stakeholder, for example, if it were considered to be in the public interest.

Report Reference: Chapter 7, Stakeholders

Given that the nature of tension and disputes between stakeholders in NFP organisations is often different to those experienced in 'for-profits', the need for access to low-cost alternative dispute resolution procedures such as mediation is important. It is also a practical way of increasing access and preventing limited resources being used to resolve disputes with stakeholders such as members.

Recommendation 10: Other remedies

It is desirable that NFP organisations and their members have access to expert, low-cost alternative dispute-resolution procedures. This is a valuable role that could be undertaken by the independent NFP advisory body recommended in this Report (see recommendation 3).

Report Reference: Chapter 7, Stakeholders

5. BOARDS

In Chapters 5 and 6 there is considerable data about Board size, composition (for example, gender, age, executive/non-executive split), remuneration, skills and experience, structure (for example, the existence of a smaller management group within the Board), meeting procedures (for example, frequency and use of technology) and organisational role. Overall results are reported as well as any significant differences between respondents based on key factors such as size, member-serving vs public-serving, tax status and principal activity.

The data shows that the average NFP company Board size is 8 directors. However, further analysis shows that, particularly for large organisations, the Board can be quite large (10 or more directors). Sometimes there may be very good reasons for a larger Board and the typical 'Top 100', 'for-profit' company model should not be assumed to be the best model for NFP organisations. However, NFP organisations need to be mindful of this issue especially in the light of the legal duties and liabilities that all directors face.

Recommendation 11: Board size

As a 'best practice' guideline, Boards need to periodically review their size to make sure they are small enough to work effectively as a group, but large enough to contain an appropriate mix of skills and perspectives. While there is no ideal size for Boards, it is unlikely that very large Boards work effectively or efficiently. One popular method among NFP organisations for dealing with the problem is the establishment of a smaller management group. However, this option can be problematic. Directors who are insufficiently involved and informed expose themselves to potential risks under their liabilities as a director. NFP organisations with very large Boards need to consider whether there are more effective ways of involving stakeholders in the organisation. Options such as involving experts or stakeholders as specialist advisors on an advisory panel might usefully be explored by such Boards. This is an issue that it would be appropriate for the independent NFP advisory body recommended in this Report (see recommendation 3) to develop.

Report Reference: Chapter 5, Board Size, Composition and Experience

The survey shows that the vast majority of NFP company Boards comprise a majority of non-executive directors. Thus, at least in theory, they are likely to be more independent and objective monitors of managerial behaviour. Indeed, NFP companies fared better overall than the 'Top 100' listed companies in this respect.

Although NFP Boards might be independent of management, NFP bodies might still consider how they can actively increase the pool of potential directors. Our study shows that it is often difficult for NFP companies, especially smaller ones, to recruit Board members. Further, the profile of NFP directors is quite narrow. Younger people, women and people from non-English speaking backgrounds are under-represented on Boards, despite the important contribution they might potentially make to NFP bodies. The pool of potential Board members might be widened by advertising and other recruitment methods.

Periodic assessment of whether the Board is constituted so as to provide the right balance of expertise and skills is important. To this end, Boards need to consider whether the current appointment process leads to the right mix of skills, experience and perspectives. It may be possible, and indeed desirable, to foster the skills of other volunteers so they have the skills and confidence to serve effectively on the Board. Alternatively, co-option or other methods can be used to fill gaps in terms of skill or experience on the Board

Recommendation 12: Board recruitment methods

There is a demonstrated need for training materials and other assistance for NFP Boards in their recruitment of Board members, as well as an ongoing assessment of the directors' mix of skills, experience and perspective. In general, NFP company Boards are currently composed of people from a narrow demographic. Many NFP organisations could benefit from the broader range of the skills and experience that are available in the general community. Assistance with this issue would be a useful role for the NFP advisory body recommended in this Report (see recommendation 3).

Report Reference: Chapter 5, Board Size, Composition and Experience

The data shows that many Board characteristics vary with the size of the organisation. For example, the size and complexity of the structure of the Board tends to increase with organisational size, and so does the support available for Board members. For example, only 60% of small organisations provide new directors with strategic and business plans compared with 84% of large organisations.

Recommendation 13: Board training

Support for Board members with training and induction is required. Smaller NFP organisations, in particular, should be targeted as they do not receive the same level of introductory material and training as their larger cousins. Consideration should be given to reaching and assisting the Boards of small NFP organisations. This is an area that would benefit from the advisory and training body recommended in this Report (see recommendation 3).

Report Reference: Chapter 6, Board Structure, Procedures and Role



16 August 2007

By email

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

Dear Sir/Madam

FINANCIAL REPORTING OF UNLISTED PUBLIC COMPANIES

Thank you for the opportunity to make a submission on this issue. My submission responds only to the companies limited by guarantee (CLG) issues.

I am pleased that Federal government has, by initiating this review, indicated an understanding that there are difficulties for those not-for-profit (NFP) organisations governed by the current Corporations Law regime. My research, two major government inquiries and other reports/articles agree that the overall regulatory environment for NFP organisations is fragmented, complex and not well tailored to the needs of the sector and its stakeholders. It is even more complex than for business which, given that the majority of NFPs are small and heavily reliant on volunteers, hinders growth and innovation by the sector, as well as necessary accountability and transparency.

As an overall comment, I would strongly urge the Federal government to look at the 'bigger picture' of how best to both support the NFP sector while promoting public accountability. I suggest this can only be achieved by the Federal government initiating dialogue with the States (via COAG, possibly with support from the Victorian government) with a view to establishing an expert taskforce to develop a nationally consistent regulatory regime for NFPs, including their public fundraising activities. Ideally, such a regime would be implemented by way of a new, comprehensive NFP specific Act.

1. WOODWARD & MARSHALL REPORT

I note the references in the Treasury Discussion Paper to my research: Woodward & Marshall *A Better Framework: reforming not-for-profit regulation* Centre for Corporate Law and Securities Regulation, The University of Melbourne 2004 (**Woodward & Marshall Report**).

In particular, in light of my subsequent experience in working with and for various NFP and organisations, I would like to re-emphasize the following findings from my research. To a large extent these findings/recommendations address the specific questions raised



in the Treasury Paper, although I have added some additional comments about those questions later in my submission.

▪ **A national regime**

As stated above, the overall priority should be the development of a single Federal statutory regime for all NFPs whether currently incorporated as CLG's, incorporated associations or co-operatives (see Woodward & Marshall Report, Chapter 4).

▪ **ASIC's role**

Since conducting the research, I have become more strongly of the opinion that there should be an independent, specialist NFP regulator. However, for as long as ASIC continues to regulate CLG's, it should take steps to make itself more friendly to NFP users. Such steps might include:

- the establishment of 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 sliding fee structure for NFP companies, based on size (discussed below)
- a plain-language guide for NFP companies

(see Woodward & Marshall Report, Chapter 4).

▪ **Modify existing Corporations Act requirements**

Several aspects of the Corporations Act need reform. These include:

- the fee structure should be revised to provide a sliding scale based on size (discussed below)
- information required for disclosure should be tailored to the needs of NFP stakeholders rather than to 'shareholders', and this needs to be supported by an NFP specific accounting standard
- the requirement to lodge audited accounts needs to be reconsidered for small NFP organisations (discussed below)
- a plain-language guide summarising the provisions/obligations relevant to NFP companies (along the lines of the Small Business) should be available
- all NFP companies should be required to have an objects clause and the directors should have a duty to pursue those objects
- all NFP companies should be required to have a 'non-distribution' clause
- the remedies available for a breach of the objects clause need to be clarified and strengthened

(see Woodward & Marshall Report, Chapter 3 and Chapter 7).

▪ **NFP legal structures**

A national regulatory regime should be implemented. It is also time to reconsider the range of existing legal structures used by NFP organisations. This would be with a view to introducing a single, specialist NFP legal structure. Whilst maintaining some level of choice is desirable (eg, ability to modify internal rules to suit the needs of the particular organisation), the current myriad of legal structures leads to confusion and inefficiencies in regulation. Consideration should be given to combining the best aspects of the corporations law and the incorporated associations regimes. The work being done by the UK government would be useful to explore. Any new structure should meet the needs of both small and large NFP organisations, and the issue of converting from existing forms should be addressed in a simple and no-cost way (see Woodward & Marshall Report, Chapter 3).

▪ **Reform of Corporations Act disclosure requirements**

The current disclosure obligations required by the Corporations Act (in particular the requirement for audited accounts by small NFP CLGs) do not achieve the appropriate balance between legitimate public and stakeholder interest in disclosure, on the one hand, and the relative cost to the size of the organisation, on the other. A sliding scale of disclosure requirements based on size should be developed for NFP organisations, and be tailored specifically to the needs of stakeholders. There should be a minimum disclosure standard required of all NFP organisations, regardless of size, and this should include:

- summary or concise financial statement, based on an NFP specific accounting standard (discussed further below)
- a description of the activities that have been carried out, and how they meet the objects of the organisation (discussed further below)
- disclosure of whether or not directors have received remuneration.

For larger organisations, further information should be supplied. This could include:

- audited accounts
- disclosure of the amount (and possibly sources) of public funding

(see Woodward & Marshall Report, Chapter 8).

▪ **Introduce a NFP-specific Accounting Standard**

The 1995 Industry Commission's recommendation that the Australian Accounting Standards Board and Public Sector Accounting Standards Board develop suitable accounting standards for NFP organisations, should be implemented. Consideration should be given to elements from which it would be appropriate to exempt small organisations (discussed further below) (see also Woodward & Marshall Report, Chapter 8).

▪ **Review overall NFP disclosure obligations**

The survey data demonstrated that a review of the *overall* reporting obligations for NFP organisations is required. Current disclosure requirements:

- are not well tailored to the needs of the NFP sector and its stakeholders
- entail considerable duplication
- have an overall load that is too onerous for most small NFP organisations.

The current reporting requirements for fundraising are State-based, irregular and often duplicate the taxation and corporations law requirements. This duplication places an unnecessary administrative burden on NFP organisations, which often rely on volunteer labour. The reporting obligations under various Acts - including the Corporations Act and various State Fundraising and Collection Acts - should be unified. Multiple filings should be avoided and low-cost, online searching facilities should be available so as to maximise transparency. It is desirable that the reporting obligations should, as much as possible, constitute a 'one-stop' report that would satisfy the needs of various bodies.

A review of NFP disclosure requirements should include consultation with the NFP sector and their stakeholders.

A review also needs to have regard to the sometimes competing concerns of a range of organisations such as funding bodies, the Australian Taxation Office, State departments administering the Fundraising/Collection Acts and peak accountant bodies, with a view to minimising the current duplication of disclosure obligations. (See Woodward & Marshall Report, Chapter 8).

- **Non-financial information**

All NFPs should be required to provide a basic level of disclosure of their main purposes and activities. Matters for disclosure might include the number of years the activity has been carried out, in what geographical areas, how those activities furthered the objects of the organisation and how accountability to stakeholders is achieved (see Woodward & Marshall Report, Chapter 8).

- **Disclosure of payments to directors**

Where directors, trustees or committee members or related parties (that is, relations or associates) receive benefits of any kind (including salaries, fees, honoraria, and in-kind compensation), these should be publicly disclosed. Consideration should be given to the application of related party transactions, or possibly new conflict of interest type-provisions, to all NFP companies. That is, removing the existing exemption for CLGs that hold a licence to omit the word 'limited' from their name. This would be in addition to finding the most effective way of ensuring that all NFP organisations disclose remuneration of directors and officers. (See Woodward & Marshall Report, Chapter 8.)

- **Fundraising accounting standards**

Further consideration should be given to the way revenue from fundraising, gifts, memberships, dues and association fees, and the sale of goods and services, is disclosed. This is in addition to disclosure of moneys spent on administration, advertising, promotion and the like. This matter requires further consideration by the Australian Accounting Standards Board. Consideration should be given to including an estimate of the number of volunteer hours donated to the organisation, because the donation of time and labour is an important and unique aspect of the NFP sector. (See Woodward & Marshall Report, Chapter 8.)

2. SPECIFIC QUESTIONS IN TREASURY DISCUSSION PAPER

As mentioned above, I reiterate these recommendations from the Woodward & Marshall Report. The following are comments on the specific questions, and additional thoughts since conducting the research.

- A. Do you support the introduction of a differential reporting regime based on size for CLGs? 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?*

A differential reporting regime based on size is desirable but there should be a minimum public disclosure standard for all NFPs regardless of size. More detailed and fully audited accounts should only be required from larger NFPs, for example, for NFPs with annual income of \$500,000 or more. For all NFPs, reporting should be in accordance with a specialised accounting standard that is tailored to the NFP situation.

It is, of course, important that any change to the reporting regime under the Corporations Act is cognisant of the obligations under the incorporated associations' regime. If not, forum shopping and other distortions may become a more significant issue.

I agree with my colleagues from the Centre of Philanthropy and Nonprofit Studies (QUT) that there is a need for ASIC to undertake a direct study of its own records. The survey undertaken as part of my research has shown that merely adopting the 'for-profit' size thresholds is not appropriate for NFPs. Although the survey I conducted was large scale, it cannot by its very nature, provide the comprehensive information needed before determining an exact differential threshold for CLGs based, for example, on income. The results from my survey highlight the need for a more detailed study of this kind.

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

I continue to be of the view that size is the only criteria that is sufficiently clear cut. I refer to the observations made on this issue in the Woodward & Marshall Report (see heading 7.1, p. 220).

C. Do you consider that CLGs 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?

Since conducting the research, I have had experience of providing advice to a corporate foundation and a large philanthropic trust.

If some NFP entities are exempt from any public reporting obligation, such grantors will (in relation to those exempt NFPs that obtain external funding) become the de-facto regulators. This is entirely inappropriate and not a role that grantors seek or want. Grantors have a different focus to a broad public policy of good governance by NFPs and, particularly in the case of philanthropic or corporate funding, the public has no way of knowing that the grantor will follow up with the NFP and/or take action if moneys are not properly expended. Other than not funding that NFP again, grantors do not have any practical enforcement powers and, understandably, may not want it to be known that the funding they had granted has not achieved the outcomes expected or, worse still, the grant funds were not properly accounted for.

D. If you support some CLGs being exempted from financial reporting, what percentage of members should be required in order to require an exempt CLG to prepare a financial report?

As the unexpected cost of an audit (especially where the accounts do not currently need to comply with the full accounting standards) can be considerable, especially for a small NFP, conferring a right on members to use this power needs to be considered carefully. I suggest that an ordinary resolution in a general meeting is probably sufficient, *if* combined with a more proactive approach by ASIC. However, I understand from experienced practitioners that it is often extremely difficult to get ASIC interested in using its powers in a NFP context. ASIC should be taking a more proactive role in the use of its existing investigative powers. Again, things could be improved by a specialist division within ASIC (as exists in the Australian Taxation Office) or, ideally, a new NFP regulator.

It would be interesting to consider data from ASIC about the nature of the complaints they receive from members and what action/advice, if any, is taken/given.

E. If you support the retention of financial reporting requirements for all CLGs, 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 CLGs to report (for example, related-party disclosures)?

Yes, a simplified minimum form of disclosure should be developed as a baseline, with additional requirements for larger NFPs. See Woodward & Marshall Report (Chapter 8) about what information should be disclosed - ie, sources of income (membership fees, grant income, fee income etc), any related party transactions and remuneration of directors.

I would also encourage the Review to look beyond the narrow ambit of financial reporting. As outlined in the Woodward & Marshall Report (in particular, under heading 5.9, Chapter 8), there is an important role for descriptive information. Indeed, 89% of respondents were in favour of such information being provided. In this regard, I also note the important doctoral research by Dr Ted Flack of the Centre of Philanthropy and Nonprofit Studies (QUT) and current practice in the UK, USA and NZ.

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

In order to reduce costs and red tape, it is critical that all jurisdictions apply the same standard, and that government grants rely on this information rather than imposing unnecessary additional or different requirements. A simplified baseline form of report should be prescribed in an appropriate accounting standard. As mentioned above, it is critical that the issue of standardisation between companies and incorporated associations is resolved so that current complexity and inconsistencies are overcome, and certainly not aggravated.

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.

I have only limited direct experience to draw on in this regard, but that experience is audit fees in the order of \$10,000 - \$15,000 for organisations with about \$1 - 1.5M in annual income. I do not have an estimate of the cost of staff and director time but organisations of this size usually employ a bookkeeper.

I would also refer to feedback from survey respondents about the high cost of audit fees relative to size: see heading 2.6.6, Chapter 3, p. 70 of the Woodward & Marshall report.

H. If some CLGs 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)?

See earlier comments. No NFP should be exempt from a requirement of minimum public disclosure. Best practice guidelines could be of assistance *in addition* to this requirement, especially if supported by freely disseminated information and low-cost, accessible training.

I. For those CLGs 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?

See comments above. There needs to be a tailored two-tiered accounting standard for NFPs. For smaller NFPs, review by their Board and, possibly, a qualified practising account should be sufficient unless the Board/members decide otherwise. The cost of auditing and a shortage of expertise within the accounting profession about NFP financial reporting issues are major problems for the sector.

J. Do you support amending the Corporations Act so that CLGs are specifically prohibited from distributing profits to members in the form of dividends?

In this regard it is important to clarify if CLGs are to be limited to NFP organisations. If so (as is generally assumed to be the case), they should not be permitted to distribute dividends to members and the Corporations Act should be amended accordingly.

As stated above, a new form of legal structure needs to be considered for NFPs - this review would consider this issue and the broader issue of what form of legal structure is needed for emerging forms of social enterprise (such as that undertaken in the UK in relation to Community Interest Corporations, see heading 5.2, Chapter 3, p. 73-74 of the Woodward & Marshall Reports).

Yours sincerely,

Susan Woodward
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