

29 August 2008

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

Dear Sir/Madam

### **Inquiry into the Disclosure Regimes for Charities and Not-for-profit Organisations**

BDO Kendalls welcomes the opportunity to make a submission to the Senate Economics Committee on the disclosure regimes for charities and not-for-profit organisations.

We are of the view that not-for-profit organisations, particularly charities, should be subject to standardised accounting and reporting requirements developed for their specific needs and circumstances. The application of International Financial Reporting Standards (IFRSs), as modified by the Australian Accounting Standards Board (AASB) for the not-for-profit sector, should be avoided, because IFRSs have been developed for the for-profit private sector. Also, the inclusion of Aus paragraphs (dealing with not-for-profit issues) in IFRSs are confusing and cumbersome to use.

Please refer to the Appendix for our detailed comments on the questions for consideration in the background paper.

Yours faithfully



Wayne Basford  
Director

## APPENDIX

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

- If so, why (taking into account concerns such as those expressed by *Choice*)?
- If not, why not?

We are of the view that the current disclosure regimes for not-for-profit organisations are not adequate for the following reasons:

- there is no single regulatory regime for not-for-profit organisations;
- there is no uniform accounting or reporting standards for charities; and
- there is no standardised accounting and reporting requirements developed for the specific needs and circumstances of charities and not-for-profit organisations.

Currently the disclosure requirements for not for profits as prescribed in Australian Accounting Standards incorporate three distinct categories:

- government and government departments;
- charities; and
- member organisations.

The current disclosure requirements follow the disclosure requirements contained within International Financial Reporting Standards (IFRSs). IFRS have been developed purely for the commercial sector and are largely inadequate for the needs of the not-for profit sector. Although AIFRS has been modified in respect of certain measurement issues by way of “Aus” paragraphs (impairment of inventory, PPE, etc.) they have not been tailored in any way in respect of disclosure to meet the needs of users of the financial report in the not for profit sector.

There is clearly a very urgent need to address the requirements of users within the not for profit sector, and to produce accounting standards which satisfy the needs of users.

Any such standard should very likely clearly distinguish between the needs of users of charity accounts and those of member organisations.

A charity’s main aim is to collect and spend monies on designated project / causes. A key performance measure of any such organisation would be to clearly report funds spent directly on projects compared with monies; held in reserve, spent on indirect overheads, fund raising activities etc. However in many member organisations (sporting clubs etc), the key element of financial reporting is just to report how monies were spent and the overall liquidity of the organisation.

In addressing this paper, we believe it is imperative to distinguish between charities and member organisations.

Charities form a key part of both the Australian economy and Australian society. It is key that confidence is maintained in this sector to ensure the both the flow of funds from donors and volunteer labour. As charities typically lack members, the format of financial reporting must be dictated by government, in order to protect donors and ensure that confidence in the sector is maintained.

The application of International Financial Reporting Standards (IFRSs), as modified by the Australian Accounting Standards Board for the not-for-profit sector, should be avoided, because IFRSs have been developed for the for-profit private sector. Also, the inclusion of Aus paragraphs (dealing with not-for-profit issues) in IFRSs are confusing and cumbersome to use. We would prefer one accounting standard dealing with all not-for-profit issues (with government not part of this standard). The standard should clearly distinguish between

disclosure formats required for charities and member organisations.

We are concerned that the primary focus of the AASB, similar to the International Accounting Standards Board (IASB), is the for-profit private sector and that not-for-profit issues are not considered adequately and in a timely manner.

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

The advantages of moving towards a singlenational disclosure regime would be many, including:

- consistant reporting throughout the sector, allowing comparison of performance across different entities. This would allow:
  - confidence in the sector;
  - identification of poor performers;
  - boards and committees to see how they compare with like organisations; and
  - donors to clearly see performance;
- efficiency in preparing accounts as accounting firms would have clear consistant rules to follow allowing disclosure templates to be developed; and
- efficiency in training accounting professionals in this sector, as only set of guidelines would need to be understood and interpreted.

The only potential disadvantage, would be to swamp smaller organisations with complex accounting disclosures. Recognising a large proportion of entities currently may only present a balance sheet and an income statement.

To automatically require all charities to produce a full general purpose regime (as modified for not for profit requirements) should not be the way forward. Instead a differential reporting regime should be established similar to the current “special purpose” report.

Further any consideration discussion in respect of extending/ improving the reporting regime in respect of not for profit entities should include a discussion as to the required level of assurance required in respect of these financial statements.

Currently not-for-profit entities are faced with the stark choice of a full audit or no assurance at all.

Again the Australian Auditing Standards Board (AuASB) and government has focused on the needs of the commercial sector. Applying “ISA plus” standards and giving the auditing standards the force of law.

This “one size fits all approach” has had significant negative impacts on the level of assurance that can be provided to the users of not for profit financial reports, including:

- significant costs of audit;
- lack of auditors willing to do this type of work pro bono;
- general reduction of registered auditors particularly in regional and rural Australia;
- potentially scoping out a large number of entities from the requirement to have their financial report subject to audit / review by an independent financial expert; and
- increasing the risk of fraud / misappropriation due to the “threat of audit “ not being present for a large number of entities operating in this sector.

The potential disadvantage is the additional burden placed on smaller not-for-profit entities. This could be minimised by the introduction of differential reporting based on a combination of classification and size thresholds within the not-for-profit sector.

In this regard we would expect the reporting requirements (including level of assurance required) to be higher for a charity than a member based organisation. In the case of charities use of size thresholds should likely be based on funds collected from donors.

Any attempt to overcomplicate reporting must be avoiding, recognising any move to fair value such services as free volunteer labour etc should be avoided at all cost.

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

Yes it would.

- Would reduce costs if operations were reported on a consolidated basis.
- Allow standard reporting templates / processes to be developed, giving efficiency in financial reporting.
- Free up accountants and auditors in respect of having to study only one set of requirements.

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

We are of the view that charities should be treated differently, because they receive money from the general public for certain charitable purposes. Transparency and accountability of this money are very important to maintain confidence in the charity.

Member organisations, operate in a significantly different governance structure to charities. This structure typically means that theoretically:

- members can decide reporting requirements;
- members can decide what level of assurance they require; and
- members can easily see if the objectives of the club are been achieved, irrespective of the financial report.

If different regimes were to apply to different parts of the sector, how would this be determined and why? For example, would it be based on classifications – i.e. as a charity or deductible gift recipient – or would different regimes apply to different organisations based on their annual financial turnover or staffing levels (or some other proxy for size and/or capacity)?

We are of the view that a combination of classification and some proxy for size should be used. Firstly, we are of the view that charities should be treated differently, because they receive money from the general public for certain charitable purposes. Transparency and accountability of this money are very important to maintain confidence in the charity. Secondly, we are of the view that small not-for-profit organisations such as churches, sport clubs, etc, should not be burdened with additional compliance costs and that some proxy for size should also be considered. We recommend a three tier approach:

- tier one – charities (publicly accountable not-for-profit organisations);
- tier two (member based) – not-for profit entities above a certain size threshold; and
- tier three (member based) - not-for profit entities below a certain size threshold.

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

Yes, there need to be regulatory reform of the not-for-profit sector. The objectives of the reform should be to create greater transparency and accountability within the not-for-profit sector through standardised reporting and disclosures. The minimum requirements that must be met for the national regulatory system to be worthwhile is the creation of standardised reporting and disclosures. Regulatory reform should apply to the whole of the not-for profit sector, taking into account categories and some proxy of size. The impetus for reform should come from the Commonwealth.

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

Yes, there should be a single national regulator for the not-for-profit sector. The national regulator should be responsible for the entire not-for-profit sector. The regulator should be independent of government. The regulator would be best located within an existing institution, such as the Australian Securities and Investment Commission. The role of the national regulator should be enforcement. The national regulator could also be making decisions about charitable status. The national regulator should be funded by federal, state and territory governments.

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

Yes, there should be a single, specialist, legal structure for the not-for profit sector. This would be best achieved through a national legislation scheme, whereby current national and state and territory laws relating to the not-for-profit sector are harmonised into uniform law.

Any move to this standardised structure should allow, easy conversion from existing types of entity, principally company's limited by guarantee and Incorporated Associations. Any changes must co-ordinated with ASIC removing any unnecessary cost burden.