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

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

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Dear Sir or Madam

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

CPA Australia welcomes the opportunity to provide comment to the inquiry. As a professional accounting body with more than 117,000 members representing professional accountants in Australia and internationally, many of our members are involved in various categories and structures of the not-for-profit sector including incorporated associations, companies limited by guarantee, trusts, societies and co-operatives as members as well as treasurers and auditors, both paid and pro bono. CPA Australia understands that charities and the not-for-profit sector contribute significantly to the economy, and will therefore always remain an area of significant interest for the accounting profession.

CPA Australia and other professional accounting bodies, in various instances, have expressed concerns about the regulatory regime for the not-for-profit sector. In September 2007, CPA Australia developed a policy for not-for-profit entities which is based on the principle of 'one country, one law, one regulator, one system'. To explain the principle, we believe that similar entities of the not-for-profit sector shall be subject to the same rules and requirements despite any differences in form. CPA Australia supports:

- the establishment of a regulator for the not-for-profit sector;
- uniform legislation on financial reporting for not-for-profit entities;
- a common source of relevant information for the sector; and
- the development of a well-resourced regulator with research and advisory capabilities.

We note that there is a variety of incorporated entities operating in the not-for-profit sector applying both federal and state legislation. CPA Australia is of the view that the referral of powers from the states and territories to the Commonwealth to enable a single regulator to administer the not-for-profit sector is the most efficient mechanism to implement the policy. CPA Australia's views are similar to those articulated in Senator Andrew Murray's paper entitled '*One Regulator, One System, One Law – The Case for Introducing a New Regulatory System for the Not for Profit Sector*' (July 2006).

CPA Australia believes that governance may be further improved for the not-for-profit sector, and the proposed regulator will have a role in determining an appropriate model for the governance of not-for-profit entities. CPA Australia suggests that the Organisation for Economic Co-operation and Development (OECD)'s Principles of Corporate Governance may be appropriate as a starting point for the development of a not-for-profit governance model. We recommend that governance for the not-for-profit sector should be implemented through the provision of good practice guidance.

As stated in the background paper accompanying this inquiry, there are approximately 700,000 not-for-profit organisations in Australia, which about 380,000 organisations are incorporated in some form. There are also a multitude of different ways to incorporate a not-for-profit entity. The federal and state legislation prescribe different, often complex and contradictory, regulatory requirements and regulators for the different structures of incorporated entities. Some of the main examples are discussed as follows:

Federal legislation

The *Corporations Act 2001* is administered by the Australian Securities & Investments Commission (ASIC) and applies to that segment of the not-for-profit sector that operates through public companies limited by guarantee. In accordance with the legislation, companies limited by guarantee are required to comply with the applicable Australian Accounting Standards. Most of these companies (approximately 68% out of 11,000 companies limited by guarantee) are relatively small with revenue less than \$1 million. Nonetheless, the financial reporting requirement is no different from that imposed on major listed companies with billions of dollars in revenue. This is a significant requirement, especially for companies limited by guarantee with limited resources. However, we acknowledge that the Treasury has progressed with the review of this area of the legislation. CPA Australia will work with the relevant bodies to assist with the review.

The interaction of legislation

State legislation governs the other types of not-for-profit entities such as incorporated associations and co-operatives. Incorporated associations are regulated mainly by different state legislation, with each state and territory has its own Associations Incorporation Act. A company limited by guarantee with similar operations and size is regulated by the *Corporations Act 2001*. As a result, the financial reporting and auditing requirements are significantly different between the two forms of entities.

Incorporated associations are regulated by state legislation which differs by jurisdiction, and are administered by different state regulators. Financial reporting and auditing requirements for incorporated associations are also different between various states and territories. This may result in the application of selected accounting standards or no requirement to apply the accounting standards in another state or territory jurisdiction. Consequently, incorporated associations are not efficient for multi-state operations, and they are legally required to be registered on a national basis by ASIC if they are to operate beyond their state of registration.

There are instances where financial reporting is prescribed by two different legislation; for example: an incorporated association registered in New South Wales is required to comply with the New South Wales' Associations Incorporation Act and the Charitable Fundraising Act. CPA Australia does not believe that this is a satisfactory outcome. In addition, there are examples of references to superseded or dated accounting standards in some current financial reporting guidelines. CPA Australia does not regard this situation as appropriate.

Meanwhile, co-operatives are administered by the *Corporations Act 2001* and the *Co-operatives Act*. In New South Wales, there is additional legislation relating to co-operatives; for example: *Co-operative Housing and Starr-Bowkett Societies Act 1998*. Some co-operatives are trading and others are non-trading which means only some co-operatives are not-for-profit. Whether a co-operative is for-profit or not-for-profit is not clearly determined by its form. In contrast, incorporated associations and companies limited by guarantee are, by their legal form, seen as not-for-profit entities. The public would better understand the not-for-profit sector with a more defined approach.

Not-for-profit entities are also required to comply with state-based fundraising and/or gaming legislation where their fundraising operations fall within the scope of the legislation. Organisations that prepare and serve food are subject to another specific state legislation. This further contributes to the scattered nature of the key pieces of legislation that would commonly apply to not-for-profit entities. While CPA Australia does not believe that the proposed single regulator should be responsible for the enforcement of all relevant legislation to the sector, the regulator should be structured to provide a central source of information for the not-for-profit sector.

CPA Australia's attached response is based on the specific questions raised (refer to Appendix A) with due consideration of the scope of this inquiry. A recurring theme of our recent submissions is the need for the regulatory authorities to reduce the burden of compliance without compromising on accountability, and to co-operate in the development of draft legislation and regulations that are consistent across the country. We have included the links to those submissions in Appendix B.

If you require further information on our views, please contact John Ngiam, Financial Reporting and Governance Policy Adviser - CPA Australia via email at john.ngiam@cpaustralia.com.au.

Yours sincerely



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Concerns about the not-for-profit sector **(Questions for consideration)**

(i) Are current disclosure regimes for the not-for-profit organisations adequate?

CPA Australia interprets disclosure regimes as to broadly include financial reporting, non-financial information and governance disclosures.

No, CPA Australia does not view the disclosure regimes for the not-for-profit sector as adequate. The sector comprises incorporated associations and companies limited by guarantee which are governed by different legislation. In addition to those incorporated structures, there are unincorporated structures such as trusts, societies and co-operatives that are not-for-profit in nature. The financial reporting requirements are not consistent between the not-for-profit organisations incorporated in different legal forms even if they are comparable in size and type of operation. The current disclosure regimes are also primarily designed for for-profit entities. Consequently, there are some elements of financial reporting and disclosure requirements which are not necessary or appropriate for the not-for-profit sector. The Australian Accounting Standards Board (AASB), a government agency that develops and maintains high quality financial reporting standards for all sectors of the Australian economy, has affirmed this view by incorporating not-for-profit sector specific accounting requirements into the accounting standards.

A recurring theme in CPA Australia's recent submissions (refer to Appendix B) is the need for the regulatory authorities to reduce the burden of compliance without compromising the requirement for accountability, and to co-operate in the development of draft legislation and regulations that are consistent across the federal and state jurisdictions.

To further illustrate, companies limited by guarantee are currently required to prepare financial reports in accordance with all applicable Australian Accounting Standards, if they are reporting entities. This is in accordance with Part 2M.3 of the Corporations Act. There is some relief for non-reporting entities because they are permitted to prepare special purpose financial reports which are required to apply selected accounting standards, and in accordance with ASIC's view, the recognition and measurement requirements of the accounting standards. In contrast, incorporated associations (which are non-reporting entities) regulated by state-based legislation (and not the *Corporations Act 2001*) are required to comply with the financial reporting requirements of the relevant state legislation, which differ between jurisdictions in Australia. This may result in the application of selected accounting standards or no requirement to apply the accounting standards.

In addition to the overall priority to simplify the legislation and bring about some degree of consistency as highlighted in our cover letter, CPA Australia encourages a rethink of the disclosure regime. As a starting point, the existing financial reporting requirement should be reviewed for relevance to the not-for-profit entities. Fundamentally, CPA Australia is of the view that the recognition and measurement requirements of the accounting standards should be similar for both not-for-profit and for-profit sectors. This is to facilitate some degree of consistency and comparability. For example, inventory of a certain value should be equally represented in the financial statements regardless of the entity's sector. CPA Australia, however, believes that there are some simplification opportunities in relation to the presentation and disclosure requirements. A more simplified financial report is justifiable for small not-for-profit entities regardless of their incorporated structure (whether incorporated association or company limited by guarantee).

CPA Australia is of the view that the specific accountability requirements of the not-for-profit sector should be communicated through governance statements, which supplement the financial statements. The objective of the governance statements is to disclose the nature and extent of operations and the achievement of objectives. To assist with some degree of comparability between the governance reporting by not-for-profit entities, a good practice guide should be developed to encompass types of information which users would expect from such entities, and more importantly the designated regulator should strongly encourage its adoption by such entities.

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

A new and specific regulator should be established to regulate all not-for-profit entities including companies limited by guarantee which are presently regulated by the Australian Securities & Investments Commission (ASIC). This model is also premised on the preferred alignment of the present inconsistent and fragmented pieces of legislation that permeates the not-for-profit sector. The consistency of legislation may be achieved by developing a federal statutory authority for all not-for-profit incorporated bodies (i.e. companies limited by guarantee and incorporated associations) by referral of powers from the governments of states and territories to a national authority. This may result in companies limited by guarantee being excluded from the scope and ambit of the *Corporations Act 2001*.

This regulator should also be responsible for non-incorporated not-for-profit organisations. We envisage the regulator would initially be primarily responsible for the disclosure regimes of the not-for-profit sector. This would encompass the financial reporting and governance functions.

The following advantages and disadvantages are listed in general terms based on the assumption that the single national disclosure regime will provide a cost-effective and efficient financial reporting framework which appropriately caters for the broad spectrum of not-for-profit organisations.

The potential advantages for a single national disclosure regime include:

1. A consistent measurement and comparable reporting system for different not-for-profit organisations.
2. A clear reference point for the sector – not-for-profit entities will be guided by a single national disclosure regime instead of the current complex financial reporting framework.
3. Efficient use of resources resulting from the clarity and consistency of a more uniformed regime.

The potential disadvantages of having a single national disclosure regime include:

1. Enforcing a uniformed regime or a 'one size fits all' approach to all not-for-profit organisations which are dissimilar in nature and operations.
2. Inconsistency and confusion may arise because of possible disclosure and presentation differences between the proposed single national disclosure regime and the developed set of Australian Accounting Standards.

CPA Australia is of the view that the disadvantages could be minimised by working with the AASB in the development of the single national disclosure regime. The AASB develops accounting standards including the requirements for the not-for-profit sector. CPA Australia is of the view that the AASB's standard-setting role and experience will be central in the development of the proposed single national disclosure regime.

(iii) Would a standardised disclosure regime assist not-for-profit organisations that undertake fundraising activities, and which 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, CPA Australia expects that generally compliance costs will be reduced because the financial reports are not required in different forms for other states and territories. Registration on a national basis with ASIC is also not required. However, where additional reporting requirements are mandated for small not-for-profit organisations that operate within a state jurisdiction, the compliance costs for these organisations may not be reduced.

(iv) 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?

A single national disclosure regime should apply across all not-for-profit organisations. CPA Australia is aware that some participants in the sector believe that charities should be treated differently from other not-for-profit entities. However, in the absence of a robust definition of 'charities' for the purposes of financial reporting, the suggested different regime appears premature.

CPA Australia is not convinced that the fundamental requirements or objective of financial reporting for not-for-profit organisations are that different from the for-profit sector. We believe that the framework for financial reporting may differ in some concepts between the for-profit and not-for-profit sectors but the differences are not expected to be extensive. CPA Australia is of the view that specific requirements of a sub-sector of the not-for-profit sector may be addressed with additional disclosures (for example: governance statements, management commentary) rather than a separate disclosure regime.

(v) 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 – ie., 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)?

Different regimes or reporting requirements may be based on the annual financial turnover. Turnover or revenue is the most objective and relevant indicator for the not-for-profit sector.

Staffing levels are not appropriate because not-for-profit organisations are often staffed by volunteers, hence the actual size of the organisations and extent of operations may be understated. Volunteers are also utilised to different extents in various organisations depending on numerous factors.

Assets are also questionable because the valuation for some categories of assets is often a costly exercise and subjective, particularly for not-for-profit organisations. For example, even the market value of real estate fluctuates depending on the economic climate and other external influences. In addition to the cost and variability, CPA Australia does not recommend the use of assets as a threshold because asset accumulation for wealth creation is not a prime objective of such organisations. In other words, an asset base as a threshold is not consistent with the nature of such entities.

Calls for regulatory reform
(Questions for consideration)

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

Yes, CPA Australia supports regulatory reform of the entire sector with different levels of disclosures and reporting requirements based on the organisation's level of turnover. The objectives of regulatory reform should focus on clarifying and aligning the financial reporting requirements for all not-for-profit organisations. The proposed regulatory reform should be driven by the Financial Reporting Council (FRC) and/or the Treasury. The FRC's charter of functions indicate that it provides a broad oversight of the process for setting accounting and auditing standards. CPA Australia views the proposed regulatory reform and the single national disclosure regime as the equivalent of developing accounting standards, hence within the functions of the FRC.

In relation to the technical reporting requirements, input for continuous development may be facilitated and managed by the AASB. The process appears similar to the development of accounting standards.

CPA Australia re-iterates its support for a simplified set of financial statements for small not-for-profit entities. We note that differential reporting is being progressed for the for-profit sector, and support the initiative. Furthermore, CPA Australia supports the extension of the principles of differential reporting to the not-for-profit sector.

CPA Australia proposes that large not-for-profit entities shall be required to apply the Australian Accounting Standards and be subject to the same audit regime as the for-profit entities. We suggest that another size tier is required for differential reporting purposes to provide some not-for-profit entities with the option of performing either an audit or a review of its financial statements. The small not-for-profit entities shall be required to maintain good governance practices, their financial information may be simplified, and an audit or review will be at the option of the members. Based on discussions with other professional accounting bodies and member consultations, the current view of the proposed tiers are as follows:

- entities exceeding \$2 million revenue are considered large not-for-profit entities;
- entities with revenue exceeding \$500,000 but less than \$2 million are the mid-tier sized entities;
- entities with revenue not exceeding \$500,000 are the small entities.

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

Yes, a national regulator for the entire not-for-profit sector is preferred. Its primary role shall be that of an enforcement authority with supportive advisory role. While some members of the accounting profession are of the view that charities may be regulated separately, this proposal will create further segments which contradict the objective of aligning and clarifying financial reporting requirements. CPA Australia does not believe that the proposed national regulator should be responsible for determining an organisation's charitable status because it may result in inconsistent decisions between the legal position and the regulator's view.

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

Yes, a single legal structure for the not-for-profit sector is ideal. However, at present, with the various incorporated structures in operation such as companies limited by guarantee and incorporated associations, CPA Australia is not convinced that there are strong cost-benefit reasons to implement a proposed single structure for the not-for-profit sector.

As a result, CPA Australia recommends that the referral of powers from the states and territories to the Commonwealth to enable a single regulator to administer the not-for-profit sector is the most efficient mechanism to commence the implementation of the proposed reform.

APPENDIX B

CPA Australia's NFP initiatives

In 2007, CPA Australia responded to the Treasury's discussion paper on unlisted public companies:

- http://www.cpaaustralia.com.au/links?14131_23992,

and we note the progress achieved since.

CPA Australia also prepared a Pre-budget Submission 2008-2009 (December 2007) which identified corporate bodies – private not-for-profit sector (paragraph 3.2) as an area for development. The submission is attached as follows: http://www.cpaaustralia.com.au/links?14131_25067.

More recently, CPA Australia also submitted to:

- the NSW Office of Fair Trading on the exposure draft Associations Incorporation Bill 2008: https://www.cpaaustralia.com.au/links?14131_29202;
- the Victorian Department of Justice on the development of the Association Incorporation Act 1998: http://www.cpaaustralia.com.au/links?14131_28654;
- the Tasmanian Department of Justice on the proposed amendment to its Associations Incorporation Act 1964: https://www.cpaaustralia.com.au/links?14131_29855;

with the aim of supporting continuous development of the legislation for incorporated associations. We have provided the information because it explains our broader perspective and consistent views on the issues relating to incorporated associations.

CPA Australia has maintained a strong interest in the not-for-profit sector. Our recent projects and initiatives include the development of a not-for-profit definition from an accounting perspective with academic researchers and input into subsequent initiatives by the Australian Accounting Standards Board (AASB) such as our response to the invitation to comment ITC 14 *Proposed Definition and Guidance to Not-for-Profit Entities*: http://www.cpaaustralia.com.au/links?14131_28657. Another relevant submission with not-for-profit references prepared by CPA Australia is in response to ITC 12 *Request for Comment on a Proposed Revised Differential Reporting Regime for Australia*, which is available via: http://www.cpaaustralia.com.au/links?14131_24266.

CPA Australia's website also includes technical and practical resources for the not-for-profit sector which include case studies on risk management, policy papers and policy statements. Our not-for-profit resources may be accessed via: https://www.cpaaustralia.com.au/cps/rde/xchg/SID-3F57FECA-321DC4EF/cpa/hs.xsl/29144_ENA_HTML.htm