



16 August 2007

By email

The General Manager  
Corporations and Financial Services Division  
Department of the Treasury  
Langton Crescent  
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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,

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