The Institute of Chartered Accountants in Australia

27 January 2012

Manager, Philanthropy and Exemptions Unit
Personal and Retirement Income Division
The Treasury
Langton Crescent
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By email: NFPReform@treasury.gov.au

Dear Sir

Exposure Draft- Australian Charities and Not-for-profits Commission Bill 2012

The Institute of Chartered Accountants in Australia (Institute) welcomes the opportunity to make a submission to Treasury on the Exposure Draft: Australian Charities and Not-for-profits Bill (the Exposure Draft).

The Institute is the professional body for Chartered Accountants in Australia and members operating throughout the world. Established by Royal Charter in 1928, we have a long tradition of leading the Australian Chartered Accounting profession.

Our members serve the public interest through their obligation to uphold high standards of service within many facets of the economy; in public practice and commerce, and sectors including government, not-for-profit and academia. Many of our members are involved in the NFP sector as directors, treasurers, accountants or auditors (in either paid or voluntary capacities) and are therefore passionately interested in the topic. Over the past few years we have regularly made submissions to both Commonwealth and State governments and at times presented evidence to inquiries on NFP issues.

The Institute has a pivotal role in promoting financial integrity in society. We do this through our leadership and our advocacy work on influencing policy and regulatory frameworks in Australia, and in relevant international settings.

We represent up to 70,000 current and future business leaders, with more than 57,000 members, and around 13,000 talented graduates working and undertaking the Chartered Accountants Program.

Through the Global Accounting Alliance, Institute members are also part of an 800,000-strong network of professionals and leaders worldwide.

We strongly support the government in its commitment to strengthening the NFP sector, including the establishment of the Australian Charities and Not-for -profits Commission (ACNC). However, given the main problems identified below we consider the implementation date of 1 July 2012 is too soon to enable full consideration of all the relevant issues. We would recommend the ACNC is still established on 1 July 2012, by separate Act dealing with the establishment and powers of the ACNC only. Any legislation actually establishing duties and responsibilities of the NFP sector should be debated further, and thereby should not become operational until 1 July 2013 at the earliest. This should give the ACNC time to consult with the various other NFP sector regulators and the sector itself in order to achieve its objective of streamlining and reducing the bureaucratic and administrative burden faced by the sector. It would give time to refine the legislation before its release and give the NFP sector adequate time to develop processes to deal with the changes. We further recommend that the Commonwealth accelerate the harmonisation of legislation, so that State based associations legislation can mirror the changes to that required for the ACNC. This will address the confusion that currently exists as to how the Commonwealth, States and Territories will work together on the NFP sector reform.

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We have included a broad range of comments, with those relating to Reporting and Audit aspects of the Exposure Draft in Appendix 1, and those relating to other areas in Appendix 2.

NFP reform elements released on 8 and 9 December 2011

The following comments relate to the package of NFP reforms released on 8 and 9 December 2011.

The relevant consultation documents are:

1. Consultation paper for review of not-for profit governance arrangements;
2. Exposure draft legislation to establish the ACNC; and
3. Consultation paper on the implementation design

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General Comments

We consider the consultation period for the three elements of reform referred to above to be inadequate for an inquiry as far reaching as this one considering the current diversity of legal regimes. Further, such consultation precedes parallel reforms in fundraising and companies limited by guarantee, which will have a direct impact upon this review. We appreciate the extension of the deadline to 27 January 2012 for the first two items. However, with the consultation period predominantly over the traditional Australian holiday season, we have found it difficult obtaining appropriate member comment in order to meet the submission deadline. It is vital for NFPs to be given the opportunity to respond to these proposals. We do understand that Treasury's intention for the new legislation to be in place by 1 July 2012 in order for the ACNC to become operational. We also understand that passing any legislation through parliament is a lengthy process, but our concern is that the there will be very little input from those that the legislation is meant to assist. Therefore the opportunity for a collaborative process so necessary for successful implementation of such wide ranging significant reforms will be lost.

We are also concerned with the regulatory burden attached to such proposals. One of the core purposes of the reforms is to streamline and reduce the bureaucratic and administrative burden for NFPs. However the paper fails to address the question of how the proposed regime will co-exist with parallel existing legislation. Many NFPs have multiple reporting requirements, particularly those grantee organisations that must provide acquittal reports to fund providers. The consultation papers do not show enough action to allow progression to a truly 'one-stop-reporting shop'. Again the opportunity to engage NFPs fully in this reform process is lost as there does not seem to be any real reduction in the reporting burden imposed on the NFP sector by multiple layers of reporting requirements. Presumably, at least at the outset, incorporated associations and other entities will be required to fulfill the requirements of at least two sets of regimes, with different regulators. It is possible that these regimes may be in conflict and at the very least increased regulatory burden will result in the need to ensure compliance with both regimes. Therefore we consider that there are still many detailed negotiations between agencies/regulators to be concluded on, before the ACNC can be operational. Only then will the sector become more confident that the requirements are not duplicative, burdensome or unclear.

Our last general point that we make in relation to all three consultation documents is that it is unclear how they interrelate. We understand the proposed legislation in respect of the governance framework is not contained in the current ACNC exposure draft. We presume this is because the outcome of the governance consultation paper will inform the proposed legislation. However, given our comments on the governance consultation paper, we strongly suggest that the outcome of this review is exposed for consultation prior to forming legislation in this area. Further, there appears to be some crossover between Division 55 of the exposure draft which covers reporting and the ACNC reporting framework section of the implementation design consultation paper. It would therefore appear to be necessary to review the implementation design consultation paper in order to provide comments on the exposure draft. However the deadlines for comment are one month apart.

The relationship between these three documents needs to be clarified and any crossover or inconsistencies highlighted and explained to all stakeholders so they can comment in an informed manner.

If you have any queries on our comments please contact Ms Kerry Hicks, the Institute's Head of Reporting via email at kerry.hicks@charteredaccountants.com.au

Yours faithfully

Lee White
Chief Executive Officer
The Institute of Chartered Accountants in Australia

Financial Statements

Section 55-20 refers to a requirement for financial statements of medium and large registered entities (as well as small entities with deductible gift recipient status) to comply with accounting standards. In terms of financial reporting this implies that these registered entities would be required by the proposed legislation to prepare 'general purpose financial statements' which are required for 'reporting entities' (both terms are defined in the accounting standards). 'General purpose financial statements' would comply with all requirements of all applicable Australian Accounting Standards, which will likely include the adoptions of a Reduced Disclosure Regime (although this is not indicated in the draft legislation). Therefore such entities would automatically lose the right to determine they were non-reporting entities thus enabling them to prepare special purpose financial statements. The application of the reporting entity concept is currently used in both the for-profit and the not-for-profit sectors to determine whether financial statements should be prepared as 'general purpose' or 'special purpose'.

For many entities a requirement to prepare 'general purpose financial reports' would be onerous and inconsistent with current practice. Many charities, particularly those receiving large amounts of public money, are likely to be producing 'general purpose financial reports' currently. However, those with less public interest may currently prepare 'special purpose financial reports' tailored to meet their users' needs. Special purpose financial statements are prepared using less onerous requirements than used in preparing general purpose financial statements. The entity's directors and management determine the most applicable recognition, measurement and disclosure requirements of accounting standards that will meet the need of the users of the financial statements. This basis of accounting is then confirmed by the auditor as part of the annual audit report.

We note that limited by guarantee companies currently must consider compliance with ASIC Regulatory Guide 85 *Reporting Requirements for Non-reporting entities* when preparing special purpose financial statements. This guidance requires the recognition and measurement requirements of all accounting standards to be applied in the formulation of special purpose financial statements. This guidance is not generally applicable or necessarily adopted by those entities regulated by states or territories. To apply this guidance to all registered charities and not-for-profit entities is likely to result in a considerable extra burden for entities in preparation and audit costs.

We do note that the Fact Sheet *The ACNC Exposure Draft Reporting and* Auditing and the Explanatory Materials refer to special purpose reporting, however this appears to refer to requests by the ACNC for information above and beyond that provided in general purpose financial statements.

We do not agree with mandating the preparation of 'general purpose financial reports' as this will increase substantially the costs of preparation and audit of financial statements, particularly for small and medium sized not-for-profits.

We note that New Zealand is currently undergoing a review of relevant accounting standards and reporting thresholds to be applied to the not-for-profit sector, primarily registered charities. This review is being undertaken by the New Zealand External Reporting Board, in conjunction with the Ministry of Economic Development. Several years ago, Australia and New Zealand entered into the Single Economic Market outcomes that were agreed to by prime ministers in both jurisdictions. Various Trans-Tasman harmonisation initiatives are included in this agreement and these include moving to consistent/comparable requirements in respect of private not-for-profit reporting. We would therefore encourage Australian and New Zealand governments and standard setters to work together towards a common outcome on private not-for-profit reporting. A strong consistent reporting regime across the two countries can only benefit our regional reputation, and enable us to have a greater influence in the global arena.

Tiered Reporting

We agree with the concept of tiered reporting, and we have spent many years as a strong advocate for tiers in the area of companies limited by guarantee. However, we have several concerns with the tiering proposed by the ED.

Firstly, we consider the revenue thresholds introduced by the Government for limited by guarantee companies are too low. Secondly, do not support the exclusion of DGR entities from the definition of small registered charities. We do not consider that small DGR entities should have the preparation and lodgement of financial information in accordance with accounting standards mandated. Thirdly we consider that further clarification is required around Section 210-10 in the draft legislation regarding defining the tiers.

Therefore we recommend the application of higher revenue thresholds across all registered entities, with no exceptions regarding the nature of the entity. We support the preparation and lodgement of financial statements for medium and large entities in accordance with Australian Accounting Standards which includes application of the reporting entity concept. Application of this concept, as discussed above, will mean that those entities determined as non-reporting entities will continue to retain the option of preparing special purpose financial statements (see above comments under Financial Statements).

For all small entities, DGR or not, we do not support the mandatory preparation of financial statements in accordance with the Australian Accounting Standards. We do consider that some financial information should be reported, but only in terms of an information statement, lodged with the regulator containing basic financial data.

The definition of small, medium and large registered entities contained in section 210-10 requires further clarification. The definition in the draft legislation seems to be based on revenues as they relate to 'an entity'. However the Corporations Law definition contained in Section 45B includes circumstances for consideration of 'consolidated' revenues in determining thresholds. We are unsure if this omission was deliberate or unintended.

The quantum of such thresholds for tiering purposes and its definition should be subject to further consultation with the sector, although our previous recommendations would at least double the current thresholds for each tier.

Audit requirements

We support the audit requirements in the proposed legislation and agree that they should be consistent with those for companies limited by guarantee in the Corporations Act 2001. One area of concern however is the requirement in 55-60(40(a) for the audit report to describe 'any defect or irregularity in the financial report'. We believe this requirement is too broad and could be construed as a requirement to report on matters which would normally be included in an audit report under Australian Auditing Standards if the auditor forms the view that the defect or irregularity is material. Further, rather than require the audit report to describe 'any defect or irregularity', in our view there is merit in seeking to replicate the obligations imposed on auditors under Section 311 of the Corporations Act. Under Section 311 the auditor is required to have reasonable grounds to suspect a contravention of the Act, and it is significant, or has reasonable grounds to suspect a contravention of the Act, and it is not significant, and the auditor believes the contravention has not been or will not be adequately dealt with by commenting on it in the auditor's report or bringing it to the attention of the directors (or responsible individual).The application of this section is expanded on by ASIC in Regulatory Guide 34 *auditor's obligations: reporting to ASIC.*

The Exposure Draft contains a requirement, under Section 55-40(3)(d), for auditors and reviewers to form an opinion on 'whether the registered entity has kept other records required by the Act'. While these requirements are similar to the current requirements in the Corporations Act 2001, we have some concern as we are yet to see the governance requirements in the draft legislation. We consider that the audit of not-for-profit governance arrangements would be beyond the current scope performed

by an auditor under the Corporations Act and therefore would be onerous on organisations and auditors. The auditor or reviewer's role should not be extended beyond specific records such as registers of responsible individuals. For instance, the auditor's responsibility should not extend to records such as those required to evidence compliance with governance structures.

The proposals contained in Division 55-40 require the audit or review to be carried out by a Registered Company Auditor (RCA), suggesting only individuals who are RCAs can undertake the work. However, Section 324AA of the Corporations Act currently allows individuals, firms and companies to be appointed as auditor. We recommend that this requirement also be introduced into the draft legislation.

Further, while the Corporations Act requires audits to be undertaken by registered company auditors, we have recommended to Treasury in their most recent consultation that audits performed for Tier 2 limited by guarantee companies should be able to be performed by those public practitioners capable of undertaking a review engagement (s324BE of the Corporations Act 2001). Our rationale for this relates to member concerns regarding the shortage of RCAs in rural areas, and the impact this shortage has on the ability for many smaller entities to have their financial reports audited.
We recommend that Treasury also consider this proposal in relation to Tier 2 entities regulated by the ACNC.

Whilst the Exposure Draft addresses the audit of financial reports, it does not address the procedures for appointment, removal and resignation of auditors which also need consideration. We recommend the legislation addressing these aspects should be framed similarly to the equivalent requirements in Corporations Act 2001, part 2M.4.

We would recommend the legislation stipulating content of the auditor's opinion as outlined in Division 55-40(3) should be framed similarly to the equivalent requirements in Corporations Act 2001 (s.308). In contrast to the current proposals for an opinion on whether the financial report is in accordance with the ACNC Act, this would require an explicit opinion similar to that required under Corporations Act 2001, confirming the financial report gives a true and fair view, and conformity with accounting standards.

Review requirements

The proposals include provisions for the content of the audit report, however similar provisions for the content of the review report have not been included. We recommend these provisions be drafted and included in the legislation to ensure there is clarity as to the content of a review report.

The proposals contained in Division 55-35 include a specific requirement to obtain an auditor's report. A similar requirement to obtain a reviewer's report should also be included.

Publicly available information statements

In respect of those entities that will not be required to prepare financial statements because of the tiered approach, care must be taken so that the information statement requirements do not become onerous and more consideration should be given to whether making this information publicly available is necessary and or useful.

In respect of those entities that are required to prepare financial statements it would seem from the suggested format of the forms contained as appendices to the Implementation Design paper that many of the requirements would already be included in the annual report. This would seem to be more duplication of reporting requirements.

Implementation and reporting frameworks

Paragraph 1.44 of the Explanatory Material sets out the requirement that 'the new reporting framework will apply for registered charities from 1 July 2013 for information for the previous financial year'.

This effectively means that charities will be required to report publicly for the first time under these requirements for the financial year commencing 1 July 2012, approximately five months from now. This clearly allows insufficient time for many charities to invest the significant time and resources to make this transition and/or allow them to restructure their affairs in a manner that would enable them to meet these requirements in the most efficient and effective manner. Transitional requirements must be drafted to ensure entities, particularly those that currently have no external reporting obligations, have the time to ensure the necessary transition in accordance with the relevant accounting standards.

Financial Year ends

The legislation drafted seems to imply that charities and not-for-profits will all have a year end of 30 June. Alternative or substitute accounting periods are only allowed with approval of the Commissioner. We do not agree with these requirements in the Act. The requirements for year ends and changes in year ends should be consistent with that applied in other existing legislation. For example, under the Corporations Act 2001 section 323D, it is relatively straightforward for companies limited by guarantee to amend their accounting period. In fact these provisions were recently introduced into the Law to reduce regulatory burden on companies. It was recognised that the ease in changing year ends was necessary so smaller corporates could plan year ends when resources were more readily available in a cost effective manner. We would like to see these provisions carried over to any draft legislation regulating charities and not-for-profit entities.

Period of lodgement of annual financial report

Section 55-10 requires that a registered entity must provide the Commissioner with the annual financial report no later than 31 October in the following financial year. This date assumes an entity has a 30 June year end, which should not be dictated by the regulator, as we have discussed in the Financial Year ends section above. Lodging the annual financial report within four months of the financial year end is a current requirement of limited by guarantee companies under the Corporations Act 2001. However this period is shorter than many entities that are incorporated associations and the requirements for acquittal reviews.

We are concerned that requiring a four month lodgement period will impose resource issues and cost pressures for many charitable and not-for-profit entities, particularly given the demand for auditors during the peak period of July to October. Accordingly, we recommend this lodgement period is a minimum six month period following year end. This period could be further extended on a tier basis if considered necessary.

Charities versus Not-for-profits

The Bill appears to be intended to apply to all NFPs, but the Fact Sheet supplied with the exposure draft indicates that the ACNC functions will initially only apply to charities. Further, the Bill itself does not make specific reference to charities. We support this staged approach to adoption of reform, however this needs to be made clear in the Bill itself, clarifying the type of organisation within the scope initially and reference to future dates to include other classes of NFP entities.

Governance Section 5 – 10

This section refers to the 'governance requirements set out in the governance section of this Act', however the draft Bill does not contain a governance section. We presume this is because the outcome of the governance consultation paper will inform the proposed legislation. Given the comments we have made in our separate governance paper we strongly suggest that the outcome of this review is exposed prior to forming legislation in this area.

Fundraising and acquittal

For many not-for-profit organisations (charities in particular), regulations surrounding fundraising acquittal continue to prove burdensome. We have not identified any proposals to reduce this burden in the current consultations. Whilst we note from the most recent not-for-profit newsletter (issue 3) that a consultation paper to review fundraising regulation is to be released in 2012, we recommend that the drafting of fundraising legislation be assigned equal importance as other proposals being considered as part of the overall ACNC strategy.

Qualifications of responsible individuals

The draft legislation requires the ACN Register to hold information which details the 'qualifications of the responsible individual in relation to the registered entity'. However, as noted in our governance consultation paper submission, we do not support the requirements for responsible individuals holding particular qualifications, experience or skills.

Enforcement

We note that there is substantial material on enforcement in the draft legislation. While we accept that the ACNC as a regulatory body requires enforcement powers, we consider that the initial role of the ACNC should focus on education. Further, discretionary powers should have an important focus throughout the legislation.

As noted in our governance consultation paper submission, currently the power to make laws with respect to incorporated associations rests with the states. The Commonwealth cannot interfere with the legislative power unless the States agree to this by a formal referral of power. Hence this is a constitutional issue that must be resolved before being able to conclude on this matter.

Further, it is unlikely the ACNC will initially have the resources or experience to be involved in any significant enforcement activities, in contrast to existing regulators.

Record retention inconsistencies

The proposed legislation and explanatory materials contain inconsistencies in respect of the requirements in relation to retention of records.

S 50-5 requires registered entities to retain the financial records for 5 years
S 55-50 requires audit working papers to be retained for 7 years
S 55-80(6) outlines the additional reporting requirements for which a request is limited for past periods of no later than 6 years.

These inconsistencies will result in unnecessary confusion and could result in inadvertent breaches. The requirements should be consistent with that in the Corporations Law which requires financial records and audit working papers to be retained for 7 years. We also recommend that transitional provisions address the circumstances where records have not been retained prior to being registered with the ACNC.

Registration

We note that the draft legislation contemplates registration with the ACNC at entity level. However it is very common for not-for-profit and charitable entities to have multiple ABNs, tax endorsement registrations and financial reporting structures through the concept of branch or divisional (sub-entity) arrangements. The reasons for multiple entities can vary from entity to entity, often related to funding, governance, structure or for practical administration purposes.
This needs to be allowed for as part of the registration process.

However, we note that difficulties could ensue as part of the reporting of financial information and could lead to duplication of reporting. Financial reporting requirements are likely to result in information lodged at the entity level which may not meet the reporting needs of government departments or public reporting. The interaction of information requirements in these areas needs further exploration to ensure that confusion does not arise.

We question how the proposed legislation on registration may be affected by any future statutory definition of charity. We note that the Explanatory materials refer to the definition of charity being based on the common law definition. The Fact sheet supporting the October 2011 Consultation Paper *A Definition of Charity* noted that the statutory definition would be applied from 1 July 2013. However the proposed ACNC legislation is silent on how this adoption may impact on those currently regarded as charities. We understand that those entities currently endorsed by the ATO as tax exempt will initially be automatically registered with the ACNC, but these entities will need to reassess this subsequently and the proposed legislation is not clear as to how this will change. We recommend that the proposed legislation in its transitional provisions clearly provide these entities with certainty regarding how they will be dealt with should the proposed review result in these entities no longer meeting the definition of charities, along with a concessional timeframe to allow for restructure if needed to meet the definition.

We note that Division 5 – 10 indicates that an entity that has previously been registered is not entitled to registration with the ACNC. Where an entity's registration is revoked, there appear to be no provisions in the draft legislation to apply for re-registration once issues that may have resulted in de-registration have been identified and rectified. We recommend this be addressed to accommodate re-registration of entities that have addressed issues that caused revocation of registration.

Responsible Individual

The definition of responsible individual seems to include concepts of director and officer as defined under the Corporations Act 2001. We would prefer consistency with the Corporations Act and thereby request that these concepts and associated duties are identified separately. Different statutory duties should be legislated for different categories of responsible individuals, for example similar to directors and officers under the Corporations Act.

Further discussion on responsible individuals should be noted from our governance consultation paper submission.