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AUSTRALIAN CHARITIES & NOT-FOR-PROFIT COMMISSION

Response to Treasury Consultation Paper Review of Not-For-Profit Governance Arrangements

Overview

The consultation paper examines issues relating to the role of the Australian Charities and Not-For-Profits Commission (ACNC) in relation to being the regulator responsible for, amongst other things, “promoting sound governance through a compliance framework to maintain the public’s confidence in NFPs”.

Powers of ACNC:

In our view there is a risk of the ACNC usurping the regulating role of other bodies such as ASIC, for companies limited by guarantee and special purpose non-profit companies, and the Department of Commerce in Western Australia, for associations and co-operatives. There is no guarantee yet that State based accountabilities will be reduced by the work of ACNC.

On face value we have at present the prospect of significant additional reporting by charities and not-for-profits to the ACNC. This is at variance with the stated intentions of the reform agenda of the Federal Government because co-operation with all of the States and Territories has not yet been secured.

“An independent one-stop shop regulator has been sought for many years by the NFP Sector and recommended in several recent reports and inquiries to reduce regulatory overlap and increase the transparency of Australia’s NFP Sector. To fully realise this ambition will require the support of the Commonwealth and each of the States and Territories.” (The Hon. Bill Shorten as Assistant Treasurer and Minister for Financial Services and Superannuation, 9 December 2011)

The consultation paper suggests that the ACNC will have a role initially with charities and later with other Not-For-Profits in monitoring their governance arrangements. The implication is that a failure to demonstrate good governance may lead to deregistration as a charity.

Reference is made to the *Final Report on the Scoping Study for a National Not-for-Profit Regulator*, which suggested at 13.6:

“over the long term, the national regulator should be provided with powers regarding asset protection, the suspension and/or removal of responsible persons, registration and deregistration, the enforcement of governance rules, investigative processes, enforcement

powers, including civil penalties and the imposition of fines, proportional compliance activities, and, dispute resolution processes.”

It is not clear how all of the above powers would work. For example a “responsible person” may be a director of a company limited by guarantee, which is a charity. That person at present can be banned from acting as a director for the maximum of five years under the Corporations Act only by ASIC. Only the members of the company can remove that person as a director. It is not clear therefore how ACNC could suspend or remove a “responsible person” in this context.

Similarly the “enforcement of governing rules” would be difficult without being the body which determines the incorporation of the charity. **It seems the proponents of the ACNC envisage an agency which is interventionist in its dealing with charities rather than simply determining the registration and deregistration of the charity.**

The Explanatory Materials Exposure Draft for the ACNC Draft Bill suggests that:

“The proposed governance principles are grouped into the following areas:

- duties and minimum standards of responsible individuals, including rules for proper organisational management and running of the entity;
- disclosure requirements and managing conflicts of interest;
- risk management procedures, including external reviews and auditing requirements;
- the minimum requirements of governing rules; and
- relationships with members (where applicable).“

These are essentially sound principles and provide a helpful framework for assessing the constitution and operations of an entity for registration and later re-registration. **What is new is the requirement for risk management procedures.**

The draft Annual Information Statement for a charitable entity requires a reference to the existence of a risk management plan for Tier 2 & 3 entities. **You will see from our response to Question 16 that we consider that this should not be a reportable item at all – but should be an educational one.**

Responsible Persons:

The definition of “responsible persons” includes an individual:

- who makes, or participates in making, decisions that affect the whole or a substantial part, of the registered entity’s activities; or
- who has the capacity to significantly affect the registered entity’s financial standing; or
- who in accordance with whose instructions or wishes the responsible individuals of the registered entity are accustomed to act (excluding advice given by the individual in the proper performance of functions attaching to the individual’s professional capacity or their business relationship with the registered entity).

This definition will be a significant concern for the many charities that exist as separately incorporated entities but are a part of a broader group. An example of this would be a Bible College, which is part of a denomination of churches. The Bible College is an incorporated association, but the College Board is accustomed to acting in accordance with the directions of the governing body of

the denomination. It may be held under this definition that the governing body of the denomination are acting as “responsible persons” in relation to the affairs of the Bible College.

It is not clear what, if anything, the ACNC would do in such a situation. The definition of shadow or de facto directors is covered in the Common Law and also in Section 9 of the Corporations Act. However it is not commonly considered in relation to associations and other legal entities, although the capacity to do so under the Common Law has existed for some time. **The issue will no doubt confuse many as it is made explicit under this proposed Draft Bill.**

Accounting Standards:

The major issues emerging in this governance consultation paper (and also in the Draft Bill) relate to reporting and auditing. Whoever wrote the Governance draft seemingly does not understand the Australian Accounting Standards. **Not only here, but also elsewhere, there is a lack of clarity in this area where accuracy is essential. The Standards are already legal obligations. The Draft Bill needs to be accurate in this area or there will be enormous conflict.**

The reference to applicable standards in paragraph 111 on page 20 contains at least two errors.

Currently in AASB 12 "Disclosure of interest in other entities" - there is a specific prohibition on its application to Not-For-Profit entities until the AASB has had time to consult on it.

In relation to AASB 120 "Australian Government Grants" - this applies to for profit entities only - the relevant standard for Not-For-Profit entities is AASB 1004 "Contributions".

Definition of Revenue:

Of critical importance is the definition of revenue to assist in determining into what Tier a charity fits.

At 1.72 on page 28 in the Explanatory Materials (EM) for the Draft Bill it identifies that “Revenue should be calculated in accordance with the relevant accounting standards.” The implication is that all recognition and measurement principles in the AASBs need to be applied as identified in the AASBs: “Framework for the Preparation and Presentation of Financial Statements”.

In identifying what are financial statements, which medium and large entities must lodge with ACNC the EM says:

At 1.95 on page 30: The financial statements for the financial year are the financial statements in relation to the registered entity required by the accounting standards.

At 1.96: The notes to the financial statements are any disclosures required by the regulations to this Act, accounting standards, and any other necessary information that is required in order to give a true and fair view of the entity’s financial position.”

The implication is that AASB 101 “Presentation of Financial Statements” will apply to the format of financial statements or if General Purpose Financial Statements are requested, AASB 1053 ‘Application of Tiers of Australian Accounting Standards’ and AASB 2010-2 ‘Amendments to Australian Accounting Standards Arising From Reduced Disclosure Requirements’ will apply. **This is a substantial increase in financial reporting obligations for many medium to large associations who rely on Special Purpose Financial Reports (SPFR) at present without reference to all of the accounting standards.** Yet the Australian Accounting Standards Board (AASB) provides a facility for

reporting on the basis of SPFR. It would be preferable for the ACNC to leave the reporting issues for AASB to set, as that procedure is understood by all.

We add that the AASB is currently reviewing several of the Accounting Standards that impact on the Not-For-Profit Sector. We suggest this gives added force to the proposal that the AASB should be the standard setter for the Sector, not the ACNC. If this is not done there is the potential for significant differences to emerge adding to the misunderstandings over reporting issues.

Assuming that the Not-For Profit entity is not a Reporting Entity the current guidance for a Company Limited by Guarantee is that a Special Purpose Financial Report for that company need only comply with the following mandatory accounting standards:

AASB 101: Presentation of Financial Statements;

AASB 107: Statements of Cash Flows;

AASB 108: Accounting Policies, Changes in Accounting Estimates and Errors;

AASB 1031: Materiality; and

AASB 1048: Interpretation of Standards.

Arguably the ACNC may be filling an information gateway role for all Government departments who may rely on the financial reports sent to ACNC for making economic decisions about the charity by way of approving or withdrawing grants. If this is the case then reporting to the ACNC has the potential to make all charities "reporting entities" and thus demand the preparation of General Purpose Financial Reports.

This would impose a significant burden on most of the Charity Sector. To ensure appropriate flexibility in reporting, the ACNC needs to specify the Australian Accounting Standards to be applied in the preparation of financial statements provided by charities in their Annual Information Statement.

This will involve an educational program for the preparers of financial statements for Tier 2 & Tier 3 entities and also for the preparers of Form A for Tier 1 entities.

We also foresee problems for the ACNC where a Tier 1 entity opts for a cash accounting basis to prepare their Form A. As their cash income becomes close to the \$250,000 threshold there will be classification issues since they will not be able to apply AASB 118 or AASB 1004, which require accrual accounting as the basis for preparation of any financial statement.

The ACNC are seeking to improve the level of accountability. While we agree with this objective it will ~~also~~ require an extensive education program and will need time to explain the implications to the associations and even to those accountants who do not normally work in the Sector. ACNC will, of necessity, need to provide assistance to them.

The discretion on a format and notes meaningful to members for financial reports is seemingly to be removed from the charity with a higher obligation to the ACNC. However, the Australian Accounting Standards Board (AASB) already provides a facility for reporting on the basis of SPFR, as SPFR reporting is used extensively throughout the Sector, including many Tier 3 entities. The introduction of a reporting format that is inconsistent with AASB requirements will only add to the uncertainties that are now developing.

We are not convinced that the ACNC approach is beneficial and again state that this is a matter that could wisely be left to the AASB.

Small Charities:

We then need to ask the question – “How workable is it for the very small charity?”

Many small charities (Tier 1) will find the understanding and application of principle-based governance very challenging. There will need to be an extensive education program to explain these matters and what is described as the proportional application of the principles.

It should be understood that the Common Law duties of directors already apply in any case to the “responsible persons” in a small charity. There is nothing new here, apart from an emphasis on risk management.

The draft Annual Information Statement for a charitable entity allows for a cash basis in the preparation of a balance sheet and an income statement. This is an obvious error since a balance sheet and income statement requires the application of accrual accounting principles. A different form for a cash basis preparation should be considered, with a statement of receipts and payments, supported by a reconciliation to movements in cash balances.

Our more detailed comments are attached as brief answers to each consultation question.

NOEL HARDING

CHAIRMAN

ADD-MINISTRY INC.

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