Submission on Draft Australian Charities and Not-For-Profit Regulation 2012
Requirements for Annual Financial Reports

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Professional Background

I am a certified practising accountant (CPA) and chartered company secretary (ACIS) with over 20 years' experience in providing accounting services for indigenous organisations in NSW and the NT.

Executive Summary

I agree with the proposed 3 tier reporting structure and the proposed reporting requirements, but wish to bring to the Committee's attention, certain issues facing accountants preparing financial statements for not-for-profit organisations receiving government grants, in particular their accounting for unspent grant funds and the possible role the Commission might have in improving their reporting and disclosure.

Classification of reporting requirements by organisation size

The Commission proposes differential annual reporting and auditing tiers for charities & NFPs, ranked by their annual revenue:

- Small - Revenue under $250,000 - No ACNC requirement for financial reporting
- Medium - Revenue $250,000 to $1,000,000 - Financial statements, reviewed by accountant
- Large - Rev. over $1,000,000 - Audited financial statements

These are reasonable classifications, commonly accepted and similar to other legislation
- such as the Northern Territory Associations Act.

However I propose that there be additional reporting requirements for organisations with $2,000,000 – 5,000,000 in revenue, and standard reporting for those with over $5,000,000 per year (similar to public companies). See page 4 for details.

Comment on examples in the Explanatory Note on Defining Revenue

Regarding the example cited by the ACNC in their Explanatory Notes, under
"What revenue does not cover – Amounts collected for others" the examples should also include:

- Any amounts received by a charity or not-for-profit, which are held in trust on behalf of people, such as Income Management Funds held by indigenous organisations

Background

In the Northern Territory, persons on CentreLink benefits receive 50% of their benefits in cash and the remaining 50% as a non-cash entitlement, which is credited to their CentreLink Basics Card, or partly paid into a trust account operated by their local community store. They can apply to CentreLink for an exemption, but these are rarely given.

For a large indigenous organisations operating remote stores, this could be up to $1,000,000 per year.

These receipts are not included in the accounting definition of Revenue, as accounting standard AASB 118 Revenue (paragraph 8) specifically excludes amounts collected on behalf of third parties. Nevertheless, given the significant amount of Income Management trust funds held by indigenous organisations in the NT & elsewhere, I feel that income Management funds received for others and held in trust, should be included in the example of non-revenue items.

Comments on Requirements for Annual Financial Statements and Notes

Paragraph 8 (3) of the draft Regulation requires financial statements to be prepared:

(a) To give a true and fair view of the financial position of the reporting entity, and
(b) In compliance with accounting standards, except where affected by subsections 4 and 5 of the draft Regulation; dealing with comparative years information, collective reporting by related entities and further information which may be required by the Charities Commissioner.

I would like to comment on Regulation (3) – Notes 1 and 2 and the draft Explanatory Material on Reporting Requirements.

Note 1 – Test: General or Special-purpose report required ?
Note 1 advises that accounting standards determine whether a registered entity will need to prepare a General Purpose financial report, or a Special Purpose report. It should also state that they also determine whether an entity is a "reporting entity" or a "non-reporting entity". It also should mention that all financial statements must be prepared in accordance with 5 key standards on:

- Presentation (AASB 101)
    - Statement of Financial Position (Balance Sheet)
    - Profit & Loss Statement
    - Statement of Changes in Equity
    - Statement of Cash Flows
    - Notes to the Statements
- Cash Flow Statement (AASB 107)
- Accounting Polices, Estimates & Errors (AASB 108)
- Materiality (AASB 103)
- Standards Interpretation (AASB 1048)

Finally, it should say that entities which are not "reporting entities" under Corporations law – hence most non-profits – will have substantially reduced disclosure requirements, for information shown in their Notes (as they will be "Tier 2" entities under standard AASB 1053).

Standard AASB 101 – Presentation of Financial Statements – defines a "reporting entity" as "[one] with users who rely on the statements for making and evaluating decisions about resource allocation." This generally refers to the investing public, who rely on these statements to make investment decisions (such as buying shares) and who cannot otherwise access investment information directly from that company.

Indigenous organisations and many other not-for-profits have generally been deemed not to be "reporting entities" and been exempted from General Purpose reporting – therefore only subject to Special Purpose reporting, by most regulatory bodies.

Nevertheless, perhaps the Commission or the panel reviewing Regulation 2012 might invite discussion on this issue.

In northern Australia, a number of large indigenous organisations have grant and revenue income in the millions – even $30 m. or more – and yet are only required to prepare Special Purpose financial statements – sometimes accompanied by further financial information required by their grant funding agencies (e.g. FaHCSIA).

Note 1 – Comments (continued)

Is it time to have a debate on the reporting classification that should apply to large not-for-profit organisations with an annual turnover over $1m. – including large indigenous organisations ?

For example, it seems anomalous that a youth foundation might be classed as a reporting entity (Explanatory Notes, page 7) and required to provide General Purpose financial statements (albeit with the reduced level of required disclosure applying to not-for-profits, under Tier 2 per AASB 1053); whilst a large non-profit organisation, serving remote indigenous communities, with a multi-million dollar income and diverse operations, is classed as a non-reporting entity and permitted to prepare Special Purpose financial statements (with their lower level of disclosure).

Might it not be more appropriate to develop a test which could oblige large non-profits – e.g. with income over $2,000,000 - to be classed as a reporting entity, and obliged to prepare General Purpose financial statements, with Tier 2 reporting concessions ?

Whilst for these a move to General Purpose statements might seem onerous; given that they would be entitled to the reduced reporting concessions under Tier 2, and that many are already including comprehensive disclosure in their notes (to meet grant reporting conditions), this should be feasible without significant cost.

Those with an annual income over $5,000,000 have even more obligations to their stakeholders, as key organisations, and might be required to prepare General Purpose Statements under Tier 1, to ensure adequate disclosure.

As stated in the Explanatory Notes, medium and large not-for-profits – including large indigenous organisations - will face 4 tests in determining whether they are a reporting entity (under the AASB's Statement of Accounting Concepts SAC 1):

- *Identification of Dependent Users*

  Arguably, many people in remote indigenous communities have an actual financial stake in their large community-based organisations – as these may keep money in safe-keeping for them, under the Northern Territory Income Management Scheme (for example, where the organisation runs community stores, which receive Income Management trust funds from CentreLink, to be accessed by individual CentreLink clients when purchasing goods at the store). Additionally, many remote community residents are financial members of their community's organisation, which usually provides a range of retail and community services (e.g. health, employment services, aged-care and child-care and local government services).

  One large indigenous organisation in Northern Australia has a turnover of over $30 m. per year and employs over 150 staff in 20 businesses and programs – yet is not a reporting entity and is only required to prepare Special Purpose financial statements.

- *Separation of management from economic interest*

  Again, in large non-profits, there may be hundreds of people directly affected by the financial circumstances of the organisation – particularly in remote communities, where the organisation might provide vital retail and community services. The limited level of disclosure in Special Purpose financial reports might mean that community members do not find out about a financial issue affecting the organisation, until it substantially affects the organisation (e.g. a government funding cut, forcing closure of community programs, or repayment of unspent grants).

Note 1 – Comments (cont'd)

- *Economic or political importance / influence*

  Often a large regional not-for-profit organisation will have significant economic or political influence in the communities it serves – as a service provider, retailer or employer.
  In a remote area, it might be the sole provider – or have only limited competition.

- *Financial characteristics*

  This test stipulates that size and indebtedness be considered – including the level of government funding and dependency upon it, saying "the greater the indebtedness or resources allocated, the greater the likelihood of [there being] users dependant on general purpose financial reports, as a basis for making and evaluating resource allocation".

  Nowadays, government grant agencies set strict conditions for their grants, and usually require a copy of the organisation's audited annual financial statements, in addition to their audited grant acquittal.

  For medium organisations with a turnover of $250,000 to $2,000,000 it would be impracticable and perhaps onerous, to require them to be reporting entities, or to prepare General Purpose statements (as Special Purpose statements should suffice).

  For large not-for-profits receiving millions in government grants, the higher level of disclosure provided by General Purpose financial statements – would be more appropriate.

  Hence a possible ACNC reporting scheme might be:

  - Annual revenue up to $250,000 - No requirement for financial reporting
  - $250,000 - 1,000,000 - Annual financial report, reviewed by a qualified accountant
  - $1,000,000 - 2,000,000 - Annual audited Special Purpose financial report
  - $2,000,000 - 5,000,000 - Annual audited General Purpose report, under Tier 2
  - $5,000,000 and over - Annual audited General Purpose report, under Tier 1

  All medium and large non-profit organisations should at least be required to disclose their Unspent Grants in their Notes – their total amount, conditions and the likelihood of a possible claim for repayment.

  Hence the review committee might look at inviting the Commissioner to include such disclosure under Sub-division 60E of the Act – covering Additional Reporting requirements.

Note 2 – Provision of Further Information, to give a true and fair view

Many medium and large not-for-profits who substantially rely on government funding, face considerable challenges in appropriately and adequately reporting their grant income, to their members and the public, under current accounting standards.

Standard AASB 1004 – Contributions – requires grants to be reported as income (in the period to which they relate) but does not require unspent grant funds to be taken-up as Liabilities in the Statement of Financial Position (Balance Sheet), under "Grants Held in Trust"
- even though there may be specific conditions set by the grant agency, that would normally require them to be shown as a Liability (and require that year's unspent grant revenue to be shown in the Profit and Loss Statement – Expense section, as "Grant Income Carried-Forward").

Note 2 – Provision of Further Information (cont'd)

Whilst AASB 1004 paragraph 61 requires disclosure of undischarged grant conditions in the Notes - e.g. unspent grants, their amounts, conditions and likelihood of a repayment requirement - this is not the same, as taking them up as Liabilities – also, the paragraph only applies to local governments and other government bodies.

For large not-for-profits (i.e. with revenue over $1 million), the failure to require unspent government grants to be included in the Liabilities in the Statement of Financial Position, as "Unspent Grant Funds held under specific conditions" means that funding agencies, regulators and the general public may **not** receive a true and fair view of the organisation's financial situation, even though the unspent grant funds might be detailed in the Notes.

For indigenous not-for-profits in Northern Australia, often providing essential services in remote communities, these unspent grants can sometimes run into several million dollars.

Failure to show them as Liabilities - even with disclosure in the Notes – might lead governments and financiers (e.g. banks) to believe the organisation has good liquidity – even though strict conditions on unspent government grants might soon require their prompt repayment, if the conditions are not met.

This reporting shortcoming might mean that organisations, and their grant providers, fail to act promptly on issues involving large unspent grants – possibly placing the organisation's liquidity at risk.

For example, an organisation might be holding unspent employment program grants, from the previous year, of say $500,000.

If the government recalls these funds and issues an invoice demanding their repayment - suddenly creating a large liability – and the organisation doesn't have the cash to repay, its' directors might have to apply to the Registrar of Indigenous Corporations (ORIC) for temporary credit relief, through the appointment of a Special Administrator, on the grounds that the organisation is unable to pay its' debts as and when they fall due (the equivalent of U.S. "Chapter 11" insolvency).

This can and does occur, in the Northern Territory.

If a bank has previously provided the organisation with finance, the bank might face a write-down or write-off – due to an investment decision based in inadequate information.

Unfortunately AASB 1004 – Contributions – only requires not-for-profit entities to observe its' paragraphs 11 to 15 – on recognition of revenue contributions (e.g. take-up of a grant as income, when the grant agreement period commences) and paragraphs 16 to 18 (requiring previous debts that a grant provider has now forgiven, to be taken-up as income – as when unspent grant funds have previously been recorded as a liability, but the grant provider has now removed any conditions that might have required them to be repaid).

Note: Government grants are often provided on the specific condition that certain targets will be met, with any unspent funds remaining at the end of the year to be re paid in the following year, unless the grant's program was still operating at the end of the year but had not yet reached its' performance target – in which case, the grant provider might allow the unspent funds to be used in the following year, provided that the target is met (e.g. job placement for young people).

Note 2 – Provision of Further Information (cont'd)

Whilst AASB 1004 requires local government and other government bodies, to disclose any undischarged grant conditions in their Notes, this requirement (under paragraph 61) does not apply to private-sector not-for-profits.

Many auditors of not-for-profits, however, include in the Notes, a disclosure of the potential financial impact of failing to meet grant conditions – particularly the amount of any unspent grant funds, that may be subject to repayment (e.g. where the conditions require repayment of leftover funds at year-end, or where performance conditions are not met).

Thus a reader reviewing a not-for-profit's Statement of Financial Position (Balance Sheet) will not be aware of any unspent grants, unless he or she reads the accompanying Notes – where there may be a brief line at the end.

The situation is further complicated by AASB 120 – Accounting for Government Grants – which covers only private for-profit entities.

Paragraph 12 states that "grants shall be recognized on a systemic basis, over the periods to which they relate".

Paragraph 32 on Repayment states that "a grant that becomes repayable, shall be accounted for as a "change in accounting estimate", firstly charged against any brought-forward grant credits [in the balance sheet], with the remainder taken-up as an expense in the Profit and Loss Statement.

Unfortunately, some audit staff have seen this standard as also applying to not-for-profits, even though it only applies to for-profit entities (paragraph Aus 1.1 – Application).

Prior to the creation of AASB 1004 – Accounting for Contributions (2007) and its' predecessor AAS27 – Local Government Reporting (1996), it was common for not-for-profits to take-up conditional unspent grants in the Statement of Financial Position, as Liabilities for "grant funds held in trust".

Impact on Charities and Non-for-Profits Commission Regulation 2012

I've raised the issue of not-for-profits reporting of unspent grants, because Regulation clause 8 (5) states that where an accounting standard is inconsistent with Subdivisions 60-E and [or] 60-G of the Australian Charities and Not-For-Profits Commission Act 2012 ("the Act"), the financial statements [of charities and NFPs] do not have to comply with accounting standards [to the extent that they are inconsistent].

Also, clause 8 (3) Note 2 states that where statements and notes prepared in compliance with accounting standards would not give a true and fair view, additional information must be included in the notes.

Furthermore, Subdivision 60E of the Act gives power to the Commissioner to require further information to be provided in particular cases, including classes of entities.

In their Explanatory Material for Reporting Requirements under the ACNC Framework, Treasury take the view that "While there is no … pronouncement on the meaning of a 'true and fair view', in nearly all cases, compliance with accounting standards is likely to lead to such a view – and as accounting standards are continuously improved and modernised, there is less scope for the operation of the additional 'true and fair view' requirement. "
[i.e. for requiring additional information].

Impact on Regulation 2012 (cont'd)

However given the impact of the current deficiencies in the accounting standards, concerning reporting requirements for not-for-profits holding unspent conditional grants – per pages 4 to 6 above – there would seem to be some scope for the Commissioner and the panel reviewing Regulation 2012, to consider developing a framework for improved reporting of unspent conditional grant funds held by not-for-profits, to enable better disclosure of financial information to their stakeholders
- allowing better planning and quickly identifying emerging problems.

In particular, the financial reporting by large indigenous organisations needs to be strengthened, to better protect the remote communities they serve.

Thank you for this opportunity to make a submission.

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