



Government of **Western Australia**
Department of **the Premier and Cabinet**
Cabinet and Policy Division

Our Ref: D1200371

Mr Chris Leggett
The Manager
Philanthropy and Exemptions Unit
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The Treasury
Langton Crescent
PARKES ACT 2600

Dear Mr Leggett

Western Australian Submission in response to the 'Review of NFP Governance Arrangements Consultation Paper' and 'Australian Charities and Not-for-Profits Commission Bill 2012 (Cth) Exposure Draft.'

I am writing to provide you with initial comments in response to the 'Review of NFP Governance Arrangements Consultation Paper' and 'Australian Charities and Not-for-Profits Commission Bill 2012 (Cth) Exposure Draft'.

The Western Australian Government has embarked on a range of reforms aimed at strengthening the relationship between Government, the public sector and the not-for-profit community sector. Funding of \$604 million over four years was allocated in the 2011-12 State Budget to ensure that the State Government pays a fair and appropriate price for the services it purchases from the not-for-profit community sector. In addition, the State Government is in the process of implementing policy reforms that will reduce the administrative burden placed on not-for-profit organisations, thereby increasing the sector's ability to innovate and respond to the needs of the Western Australian community. As such, there is a common objective with the proposed Commonwealth Reforms. Western Australian considers it critical to ensure that both jurisdictions' reforms are complementary and not add an unnecessary level of additional administrative burden on the not-for-profit sector.

Further to the direct reforms with the not-for-profit community sector, the Western Australian Government is engaged in the ongoing process of reforming the *Associations Incorporation Act 1987 (WA)*; the legislation that governs associations incorporated within the State. Many not-for-profit organisations operating in Western Australia fall within the jurisdiction of these laws.

Western Australia is concerned that the proposed Commonwealth reporting obligations would place an undue administrative burden on smaller organisations, and would be in conflict with proposed reforms to reporting obligations in Western Australia's Incorporated Associations Law. The Western Australia Department for Commerce has

highlighted several areas where reporting requirements in the Commonwealth's Bill could be amended in the Attachment, including:


- the accounting standards registered entities must comply with (Clause 55-20(3));
- the power of the Commissioner to grant audit or review exemptions (Clause 55-35);
- the period of time for which financial records must be retained (Clause 50-5(4));
- the circumstances in which an auditor must produce an audit report, and the contents of such a report (Clauses 55-40 and 55-60);
- the accounting period used by registered entities (Clause 55-90); and
- the period of time in which a registered entity must lodge an annual information statements (Clause 55-10(2)).

Western Australia requests that the Commonwealth consults comprehensively with the States and Territories on appropriate reporting requirements and to resolve other potential conflicts or overlaps with Incorporated Associations and other relevant legislation.

Unincorporated and informal not-for-profit community groups have been identified by the Productivity Commission as the most common form of not-for-profit organisation in the country. They are the organisations most reliant on volunteers rather than professionals for their governance and operations, and form an important segment of the not-for-profit community sector. However, unincorporated and informal groups that do not interact with government, earn below the level of income that will require reporting under the proposed legislation and/or do not have charity status will fall outside the jurisdiction of the *Australian Charities and Not-for-Profits Commission Bill*. Given that it is within these small, informal not-for-profit community groups that the greatest risks may lay in relation to governance and operational responsibilities, clarity is sought as to how the proposed reforms will affect these organisations, balancing the risk of an onerous formal disclosure regime with community expectations of accountability (as per paragraph 118 of the ACNC Consultation Paper).

Should you wish to further discuss issues raised in this submission, please do not hesitate to contact me on (08) 6552 5953.

Yours sincerely



Rebecca Brown
EXECUTIVE DIRECTOR, STRATEGIC ISSUES UNIT

Attached: Department of Commerce (Western Australia) feedback on Exposure Draft of the *Australian Charities and Not-For-Profits Commission Bill 2012* (Cth).

ATTACHMENT

DEPARTMENT OF COMMERCE (WESTERN AUSTRALIA) FEEDBACK ON EXPOSURE DRAFT OF THE *AUSTRALIAN CHARITIES AND NOT-FOR-PROFITS COMMISSION BILL 2012* (CTH)

FINANCIAL REPORTING AND AUDITING REQUIREMENTS – CHAPTER 3

The Department of Commerce (Consumer Protection Division) (“the Department”) is currently finalising drafting instructions to amend the *Associations Incorporation Act 1987* (WA) (“the AIA”), which regulates incorporated associations in Western Australia. The new Part VI of the AIA will contain financial reporting and auditing requirements for incorporated associations.

In determining the most appropriate obligations for incorporated associations in Western Australia, the Department has consulted with accountants and registered company auditors with experience in preparing and auditing the accounts of not-for-profit bodies, including incorporated associations. The Department has also considered various reporting and auditing obligations in other jurisdictions, both at State and Commonwealth level and has obtained public feedback regarding reporting and auditing obligations of incorporated associations in Western Australia.¹

Based on the work undertaken, the Department is in a position to comment on the *Australian Charities and Not-for-profits Commission Bill 2012* (Cth) (“the Bill”), which will apply to those incorporated associations in Western Australia that are entitled to registration under clause 5-10 of the Bill i.e. incorporated associations that are not-for-profit entities, which meet the proposed governance requirements, hold ABNs, have not previously been registered entities, are not terrorist, criminal, outlaw or similar entities and have any of the purposes outlined in clause 5-10(3) of the Bill.²

Given the number of subtypes of registered entities in clause 5-10(3), it is likely that a wide variety of not-for-profit entities will be affected by the Bill, including some incorporated associations in Western Australia. Although the Australian Government has indicated that the reporting requirements will initially apply only to registered charities from 1 July 2013, it is intended that they will apply to other not-for-profit entities in the future, but not before 1 July 2015.³

The Department is concerned that some of the financial reporting requirements of Chapter 3 of the Bill will be too onerous and costly for some incorporated associations to comply with, given their size and limited resources. In order to balance the need for sound governance and accountability by incorporated associations who fall within the jurisdiction of the Bill, with the costs and practical burdens of compliance, the Department recommends that the Bill be amended to account for these concerns.

¹ This feedback was obtained with respect to the *Associations Incorporation Bill 2006* (WA).

² i.e. charitable purpose, promotion of Australian industry, encouragement of community entertainment, scientific purpose, advance and further the interest of employees or employers and community service purpose.

³ As reported in Treasury’s Not-for-profit Reform Factsheet ‘The ACNC Exposure Draft Reporting and Auditing’ dated 9 December, page 2.

1. Clause 55-20(3): Compliance with all accounting standards

Recommendation: Pursuant to clause 55-20(3) of the Bill the financial statements that must be lodged by medium and large registered entities⁴ must comply with the entire ambit of accounting standards issued by the Australian Accounting Standards Board. The requirement to comply with all accounting standards is seen as unnecessarily costly and impractical, given the limited resources of some associations and the fact that some of these standards are of no relevance to incorporated associations. It would be preferable to require compliance with “relevant” accounting standards.

The requirement to comply with the entire ambit of accounting standards is particularly burdensome on incorporated associations with limited revenue. Many associations are staffed largely by unpaid volunteers and lack the funds to pay for professional accountants. In order to comply with all accounting standards, some of which are of no relevance to incorporated associations, some associations may have to upgrade their internal systems to enable recordkeeping that would enable more sophisticated financial statements to be prepared. Staff, including volunteers, may need re-training, which will impose additional costs on the association.

For example, an incorporated association to which the Bill applies and that generates revenue of less than \$250 000 and holds deductible gift recipient (“DGR”) status will be regarded as a medium registered entity. To require such a relatively small entity, with limited financial resources, to comply with the entire suite of accounting standards, is both costly and onerous.

The Department considers it more appropriate that a medium or large registered entity should be required to comply only with those accounting standards that are relevant to an entity of its kind, rather than the entire suite of accounting standards. For example, regulation 13A of the *Associations Incorporation Regulations 2009* (Victoria)⁵ could be adapted to suit the Bill as follows:

The financial statements of medium and large registered entities must be prepared in accordance with the relevant accounting standards that apply to an entity of its kind and that relate to the preparation of financial statements for that financial year.

2. Clause 55-35: Requirement to review or audit triggered by non-recurring increases in revenue

Recommendation: The Bill’s financial reporting and auditing requirements for a registered entity depend on whether an entity is classified as small, medium or large pursuant to the Bill. The classification is based on the entity’s revenue, as determined by accounting standards. Comment: It is recommended that the Bill be amended to enable the Commissioner of the ACNC (“the Commissioner”) to provide an exemption from the reporting and auditing requirements where an entity is classified as a medium or large registered entity in a particular financial year due to a non-recurring increase in revenue.

⁴ Clause 55-10 requires medium and large entities to lodge annual financial reports, with the contents of the financial reports, including financial statements, being defined in clause 55-15.

⁵ This was recently amended by the *Associations Incorporation Amendment (Fees and Other Matters) Regulations 2010* (Victoria).

Pursuant to accounting standards, revenue includes both income and gains. On occasion, a registered entity could experience a one-off, non-recurring increase in revenue (such as a gain from the sale of a non-current asset) which would not be representative of the entity's ordinary revenue-generating capacity yet cause it to fall within a higher classification for a particular financial year. The increase in revenue, which causes the additional reporting burden, may not necessarily improve the financial position of the entity such that it can cope with the increased reporting and auditor costs.

For example, a small or medium entity may be pushed into the large classification or a small entity into the medium classification. Particularly in the case of an otherwise small entity being regarded as a large entity for a financial year, the entity would be required to comply with all accounting standards and undertake an audit by a registered company auditor. Because the entity is ordinarily a small entity, it may not have the internal systems in place to generate the requisite financial statements or the resources with which to pay a suitably qualified auditor.

Pursuant to clause 55-35(1)(a) of the Bill the Commissioner may alleviate a medium entity from undertaking a review. However, the Bill does not outline the grounds on which this may occur and there is no discretion in the Bill to allow the Commissioner to alleviate a large entity from an audit.

The Department recommends that the Bill be amended to enable the Commissioner to provide an exemption from the reporting and auditing requirements where an entity is classified as a medium or large registered entity in a particular financial year due to a non-recurring change in revenue. For example, the wording of section 30AB of the *Associations Incorporation Act 1981* (Victoria)⁶, with appropriate amendment, could be inserted into clause 210-10 of the Bill as follows:

(5) On application by a registered entity, the Commissioner may, for the purposes of a financial year, declare a registered entity to be:

(a) a small registered entity; or

(b) a medium registered entity.

(6) The Commissioner may make a declaration under subsection (5) only if the Commissioner is satisfied that unusual and non-recurring circumstances have occurred that warrant doing so.

(7) An application by a registered entity to the Commissioner for a declaration under subsection (5) must be made within 5 months after the end of the financial year.

The above places the burden on the registered entity to explain why they should be regarded as a smaller entity for reporting and auditing purposes. Further, proposed subclause (7) provides for 5 months, rather than the 3 months provided for under the *Associations Incorporation Act 1981* (Victoria) to enable the entity enough time to determine their final revenue figure for the financial year, given that professional assistance may be required in doing so.

⁶ This section was inserted into the Act pursuant to the *Associations Incorporation Amendment Act 2010* (Victoria) with commencement date of 1 July 2012 pursuant to the *Consumer Acts Amendment Act 2011* (Victoria).

The Department notes that clause 55-80 of the Bill already contemplates the reverse situation i.e. where the reporting and auditing burden for a particular registered entity should be increased, despite the reported level of revenue of the entity. The clause enables the Commissioner to require a particular registered entity to prepare additional reports.

3. Clause 50-5(4): Retention of financial records

Recommendation: Pursuant to clause 50-5(4) of the Bill, registered entities must retain records, including financial records, for 5 years “*after the transactions, operations or acts covered by the records are completed*”. It would be more appropriate to retain financial records for 7 years *after the end of the financial year* in which the transactions are completed.

Given that both companies and auditors are required, pursuant to section 286(2) and section 307B of the *Corporations Act 2001* (Cth) respectively, to retain their financial records and working papers for a period of 7 years, it may be appropriate to amend the 5 year period in clause 50-5(4) of the Bill to 7 years. Further, this would enable internal consistency within the Bill, because auditors are required to retain their working papers for 7 years pursuant to clause 55-50 of the Bill.

The requirement that the period of retention commences from *after the transactions, operations or acts are completed* is also problematic in the case of financial records and will be too burdensome on incorporated associations. Given the volume of financial transactions that may occur in a financial year, this provision as currently drafted would result in separate retention dates for each separate transaction of an incorporated association. It would be more appropriate to retain financial records for 7 years *after the end of the financial year* in which the transactions are completed rather than after each individual transaction is completed.

4. Clauses 55-40 and 55-60: Reports of audit and review

Recommendation: The Bill does not currently require a report of a review to be produced, or stipulate the contents of such a report. A clause should be inserted into the Bill to require an auditor conducting a review to produce a report and secondly, to identify the contents of the report. Further, it should be an offence for an auditor conducting a review not to comply with the clause.

We note that clause 55-40 of the Bill outlines the items on which an auditor must form an opinion for both a review and an audit. In addition to forming an opinion, an auditor conducting an *audit* of a medium or large registered entity is required to produce an audit report, the contents of which are outlined in clause 55-60.

However, the Bill as currently drafted does not require an auditor conducting a *review* of a medium registered entity to produce a report and consequently does not identify the contents of such a report. This means that there is no certainty that firstly, a review has been conducted and secondly, that nothing has come to the attention of the auditor conducting the review that causes the auditor to believe that the financial statements have not been prepared as required. The auditor is therefore not required by the Bill to provide the negative assurance opinion which is ordinarily the outcome of a review.

Clause 55-60 of the Bill creates a duty on the auditor conducting an audit to prepare an audit report, with non-compliance being an offence of strict liability. However, an auditor conducting a review who had failed to produce a report would not be liable for such a failure.

The Department recommends that a clause be inserted into the Bill to require the auditor conducting a review to produce a report and secondly, to identify the contents of the report, with it being an offence for an auditor conducting a review not to comply with the clause.

Despite the absence of such a provision in the Bill, the auditor, in fulfilling professional standards, would prepare a report of a review. However, it is nevertheless preferable that a clause be inserted into the Bill so that it is mandatory pursuant to the Bill, independent of professional standards observed by auditors and outside of the Bill.

5. Clause 55-90: Accounting period

Recommendation: Given the number of entities that will be entitled to register pursuant to the Bill, and that a number of these do not use a financial year ending on 30 June, it is recommended that the Bill be amended to enable registered entities to select an accounting period appropriate to their circumstances.

The Bill only allows registered entities to use an accounting period (i.e. financial year) ending on 30 June, although the Commissioner may approve a different financial year pursuant to clause 55-90.

This requirement does not enable incorporated associations that would fall within the jurisdiction of the Bill the flexibility to choose an accounting period most appropriate to their circumstances unless they obtain Commissioner approval. The Department has received advice that some incorporated associations, particularly schools and sporting associations, employ financial year ends other than 30 June, such as 31 December.

Given the cost and inconvenience for such associations to adopt a financial year ending on 30 June and the shortage of registered company auditors particularly around 30 June, the Department considers that it is more appropriate that registered entities be allowed to choose their financial year without having to seek Commissioner approval to adopt a substituted accounting period.

6. Clause 55-10(2): Timeframe to lodge financial reports

Recommendation: The Bill requires registered entities to adopt a 30 June financial year end, and to lodge annual information statements in an approved form, and financial reports, by the following 31 October. The Bill currently provides for the Commissioner to grant an extension of time for the lodging of the annual information statements in the approved form. It is recommended that the Bill be amended to:

- i) increase the time frame for lodging the annual information statement and financial reports from four months to six months; and
- ii) empower the Commissioner to grant an extension of time for the lodging of financial reports.

The Bill requires registered entities to adopt a 30 June financial year end and for financial reports to be lodged by 31 October in the following financial year. Medium and large registered entities therefore only have four months within which to lodge financial statements that comply with all accounting standards, are true and fair and have been reviewed or audited by a registered company auditor.

Given the time reasonably taken to prepare financial statements that comply with all accounting standards and to undertake a review or audit in accordance with auditing standards and the shortage of registered company auditors, the timeframe of four months is short and would be unattainable for some incorporated associations. Further, some incorporated associations rely on unpaid volunteers to undertake their bookkeeping and preparation of accounts, given the lack of resources to engage professional accountants. Such associations may require more time to prepare the financial statements. Six months would be a more achievable timeframe.

Although clause 196-55 empowers the Commissioner to defer the time within which an approved form must be lodged, which would include the annual information statements, the Department recommends that a clause be inserted into the Bill to enable an entity to seek an extension of time within which to lodge a financial report as required by clause 55-10. Although the financial reports are attached to an approved form, being the annual information statement, the financial reports are not themselves an approved form and therefore the extension under clause 196-55 does not apply to the financial reports.

Conclusion

The Department acknowledges the intention of the Bill in ensuring the good governance, accountability and transparency of not-for-profit entities. However, in order for the Bill to achieve its additional objectives of reducing compliance costs and regulatory duplication for such entities, the Bill should be amended as recommended above.

Given the diverse range of entities which will fall within the Bill's jurisdiction, the costs and practical burdens of compliance with the Bill should be carefully balanced with the need for sound governance and accountability, bearing in mind that these entities receive varying levels of government and public support.

In particular, the Bill's current requirements that all medium and large registered entities (including entities that would otherwise be small but for their DGR status) comply with the entire suite of accounting standards, use a 30 June financial year end and lodge financial reports by 31 October require amendment.