

Industry Insider

Not-for-profit

October 2010

Standard Chart of Accounts for NFPs arrives

In March 2010's Industry Insider, we noted that the Productivity Commission recommended the introduction of a standard chart of accounts that is linked into an XBRL Standard Business Reporting structure.

It was announced following the April 2010 meeting of the Council of Australian Government (COAG) that: "COAG also agreed to additional reforms for the not-for-profit sector, including an implementation plan and governance structure to develop a nationally consistent approach to fundraising regulation, and the adoption of a standard chart of accounts where possible by 1 July 2010."

The Commonwealth, State and Territory governments have now adopted the new national Standard Chart of Accounts (SCOA) for the not-for-profit sector. The chart of accounts will be used to define the way a government funder asks for basic financial information. The purpose is to make sure that different government funders ask for basic financial information in the same way so that NFPs can report in a consistent format.

Adoption of the SCOA by not-for-profit groups is voluntary. The SCOA was developed by the Queensland University of Technology (QUT) and is available on from the QUT website: <https://wiki.qut.edu.au/display/CPNS/National>



Maintaining sufficient reserves to protect your organisation

For not-for-profit organisations — indeed, for all organisations — maintaining adequate reserves is essential to establishing financial stability. These reserves provide a cushion to deal with operating deficits that may arise because of unexpected events, economic uncertainties or lean funding periods.

In not-for-profit organisations, reserves typically fall into three categories:

- Unrestricted funds that are available for general operations
- Funds that are temporarily restricted by donors for certain purposes and/or for future time periods
- Permanently restricted funds that are to be maintained in perpetuity.

Many not-for-profit organisations do not have a formal reserves policy in place. They should. This policy should clearly articulate and link to the mission and activities of the organisation. It should also be discussed with and approved by the governing board. Management should use this policy to establish a comprehensive reserves plan linked to the strategic plan and annual operating and capital budgeting processes.

When establishing your reserves policy it is important to ask a number of key questions:

1 Should temporarily and permanently restricted funds be included when determining reserve levels?

Operating reserves - funds that are available to support an organisation's day-to-day operations - are the appropriate measure to consider.

In addition, temporarily restricted funds restricted simply because of a time restriction but that can be spent for any purpose once released, should be considered part of the operating reserves.

2 Is there an average percentage that constitutes a reasonable reserve?

Put simply, no. Applying a general percentage (e.g., one year of operating expenses) as a yardstick to all not-for-profit organisations would be a mistake. Not-for-profits should assess the reasonableness of their reserves based on factors pertinent to their individual situations and the subsectors in which they operate.

3 What factors* should be considered when determining reserve levels?

- Mission and long-term plans or strategies
- Type of organisation: e.g., higher education, religious, social services, museums, cultural, associations, foundations, etc
- Corporate structure: e.g., sole entities, loosely affiliated groups, etc
- Investment in the physical plant: e.g., the facilities owned and/or leased

- Complexities of the debt structure
- Current and future commitments
- Funding sources, including fundraising activities
- Workforce compensation and benefits issues.

*The above list is not exhaustive and you should take into account the specific circumstances of your not-for-profit organisation.

In addition, a “prudent-person” measurement should be considered when assessing the appropriateness of reserves: Would a prudent person, exercising due care and proper stewardship over the organisation's resources, set aside such a level of reserves?

The importance of maintaining adequate reserves cannot be overstated. With so many constituencies relying on the work of not-for-profit organisations, it would be fiscally irresponsible not to accumulate and maintain an adequate level of reserves. Should you have any concerns about the adequacy of your not-for-profit organisations reserves levels, contact your usual Grant Thornton advisor who would be happy to discuss this matter with you in detail.

What do Bill Gates, Warren Buffet and Paul Newman have in common?

...they could all be the next contributors to your not-for-profit.

New reports out of the US confirm that forty of the world's wealthiest entrepreneurs have joined forces with the likes of George Lucas (Star Wars creator), Michael Bloomberg (Bloomberg founder) and Paul Allen (co-founder of Microsoft), signing up to the "Giving Pledge" (<http://givingpledge.org>) and agreeing to give away huge chunks of their fortunes. Buffett and Gates who have pledged to give away at least 50% of their fortunes, plan on taking their initiative to Asia (starting with India and China) where they will try to convince billionaires to follow their lead.

The Pledge does not involve pooling money or supporting a particular set of causes or organisations. The pledge asks only that the individual give the majority of their wealth to philanthropic causes or charitable organisations, which can only be seen as a positive, as entities reliant on charitable giving were hit hard by the GFC.

For some time Paul Newman's Own (www.paulnewmansown.com.au) has been conducting annual charity drives and since 1984 has given over A\$14 million to charities in Australia and New Zealand (over US\$280million worldwide since 1982). Whilst historically the foundation has donated funds to general



charitable and educational projects, in 2010 half of the funding was allocated to charities seeking a vehicle to assist them in carrying out their charity work. Although entries for the 2010 funding have closed, March 2011 should be pencilled into the calendar to ensure that an application for 2011 is completed.

Even Australian big businesses have charitable giving schemes aimed at supporting social or environmental causes. ASX listed, ethical investment manager, Hunter Hall International Limited has a policy of donating 5% of its pre-tax profits to charitable organisations. Donations are shareholder driven and each shareholder is invited to nominate a charity for their proportion

of the annual donation from a list compiled by the Shareholder Nominated Charitable Donations Scheme Committee.

It is likely that either a board member, an employee or contributor to your organisation holds shares in Hunter Hall and may have to allocate their share of the annual donation to another organisation. Opportunities to increase donation contributions (from the likes of Paul Newman's Own and Hunter Hall) are out there if you are willing to do some ground work.

We will endeavour to continually keep you informed of dates to remember so that you don't miss out on these and other opportunities.

The Henry tax review and the not-for-profit sector

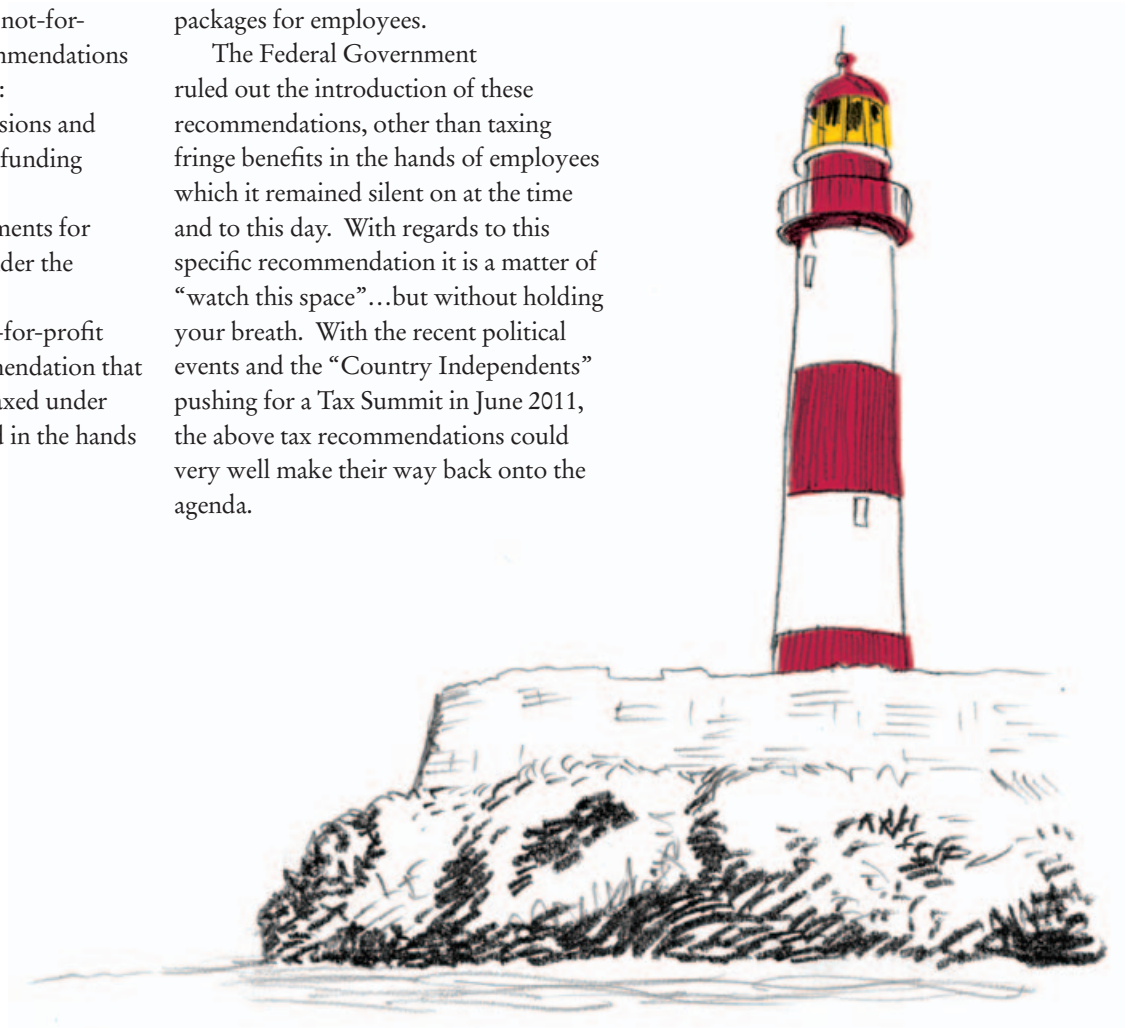
The Henry tax review was commissioned by the previous Rudd Labor government to undertake a comprehensive review of Australia's tax regime. The report and the Federal Government's response was handed down on 2 May 2010.

In the lead up to the release of the report, speculation was rife regarding significant reform to the existing taxation concessions available to the not-for-profit sector. Specific recommendations made in the report included:

- Removal of FBT concessions and replacement with direct funding assistance
- Simplifying tax arrangements for clubs currently taxed under the principle of mutuality
- While not a specific not-for-profit sector change, a recommendation that remuneration benefits taxed under the FBT regime be taxed in the hands of employees.

All these changes, if implemented, would have a significant impact on the sector, including the structuring of remuneration packages for employees.

The Federal Government ruled out the introduction of these recommendations, other than taxing fringe benefits in the hands of employees which it remained silent on at the time and to this day. With regards to this specific recommendation it is a matter of "watch this space"...but without holding your breath. With the recent political events and the "Country Independents" pushing for a Tax Summit in June 2011, the above tax recommendations could very well make their way back onto the agenda.



Another period of uncertainty for Registered Clubs

The Executive Director of Clubs Australia called it “a black eye for not just registered clubs, but all Australians” when Prime Minister Julia Gillard agreed to implement a mandatory pre-commitment system for all poker machines across Australia and to limit ATM cash withdrawals to just \$250 a day, to win the vote of the Member for Dennison (Andrew Wilkie). Not wanting to get stuck in the political debate, this decision will require Registered Clubs to find cash or in some instances obtain debt to enable them to install and operate new pre-commitment systems in their venues.

The Productivity Commission’s report into gambling, which was released as final on 23 June 2010, did not propose the early adoption of pre-commitment. It also noted that pre-commitment systems for gaming machines have been trialed or implemented in recent years in Australia and overseas. The latest trials in Australia concluded in 2009 in South Australia and Queensland.

Findings of the South Australian and Queensland trials

- Harm minimisation features available generally included daily spend limits, account summary print-outs, breaks in play and duration reminders
- Gamblers who signed up for the trials preferred setting short-term limits over setting breaks in play, however in one South Australian trial 85% of card holders did not set any limits
- Players who signed up for trials regularly exceeded spending limits or set breaks in play
- There was generally strong support and interest in cashless gaming
- A reduction in daily turnover was seen in regular players who set limits ranging from 25% to 40%

Costs of pre-commitment systems Revenue

Nobody is psychic! And therefore an accurate prediction of what pre-commitment systems would cost Clubs, in terms of revenue reductions, is a grey area. The smoking bans of 2006-07 were going to spell the end of the

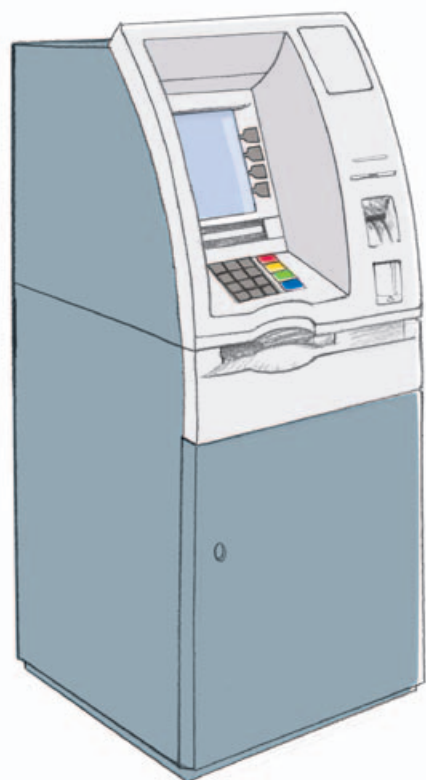
Club industry at that time and although there was some loss of Clubs and a considerable amount of consolidation within the industry, those that were proactive actually saw the change as an opportunity to provide an increased level of experience to their customers.

Cap-ex

What can accurately be predicted is the capital cost of implementing a pre-commitment system. It all depends on whether the gaming machines require smart-card terminals to be installed or not.

- A Club that does not have smart-card terminals on their gaming machines is looking at a cost of approx \$1,500 per machine. So on 50 machines, \$75,000.
- A Club that has smart-card terminals already may only require an update to the software currently being utilised.

So just when it looked like relationships between Registered Clubs and the Government were starting to become amicable, this issue has flipped the club industry again. Unfortunately, should there be a significant fall in revenues the people that will be affected the most will be the people supported through donations made by Clubs and the 80,000 people that they employ.



Corporations Act and financial reporting reforms to ease the compliance burden

In June 2010 the Government approved the Corporate Reporting Reform Act which aims to cut red-tape and improve Australia's corporate reporting framework. The financial statement relief applies to 30 June 2010 financial statements.

The key reforms include:

- Establishing a three tiered differential reporting regime for companies limited by guarantee under the Corporations Act 2001:
 - Revenues <\$250K and no deductible gift status – no Corporations Act accounts/audit requirements
 - Revenue <\$1M – streamlined directors report and annual report to shareholders, option of an audit review by any practicing certificate holder rather than an RCA audit
 - Revenues >\$1M – streamlined directors' report and annual report to shareholders
- Allowing companies to disclose summary parent-entity financial information rather than full parent-entity statements
- Replacing the 'profits' test for paying dividends with a more flexible solvency type test
- Providing greater flexibility for companies to change their year-end date
- Expanding the range of entities that are required to comply with section 299A of the Corporations Act

- Refining the statement of IFRS compliance in the directors' declaration
- Clarifying the circumstances in which a company can cancel its share capital

The Corporate Reporting Reform Act contains a new streamlined directors' report (S300 B) for those limited by guarantee companies that are required to prepare financial statements as from 30 June 2010. This replaces the general corporate directors' report (S299 and S300). Small limited by guarantee companies (revenues of less than \$250,000 and do not have deductible gift recipient status) of course are exempted from the requirement to prepare a financial report.

The intention of the changed legislation was to exclude the large number of provisions that are not relevant for typical not-for-profit limited by guarantee companies. These include disclosures relating to the payment of dividends and options issued to directors as remuneration. Given that not-for-profit companies are generally purpose or objective driven, the Government argued that stakeholders in not-for-profit

companies are likely to be particularly interested in the objectives of the organisation and how the activities conducted during the period contributed to achieving those objectives.

Section 300 B of the Corporations Act sets out the requirements for the annual directors' report of companies limited by guarantee which are as follows:

S 300 B: Annual directors' report—companies limited by guarantee

- The directors' report for a financial year for a company limited by guarantee must contain a description of the short and long term objectives of the entity reported on:
 - setting out the entity's strategy for achieving those objectives
 - stating the entity's principal activities during the year
 - stating how those activities assisted in achieving the entity's objectives
 - stating how the entity measures its performance, including any key performance indicators used by the entity
- The entity reported on is:
 - the company (if consolidated financial statements are not required); or
 - the consolidated entity (if consolidated financial statements are required)
- The directors' report for a financial year for a company limited by

guarantee must also include details of:

- the name of each person who has been a director of the company at any time during or since the end of the year and the period for which the person was a director
- each director’s qualifications, experience and special responsibilities
- the number of meetings of the board of directors held during the year and each director’s attendance at those meetings
- for each class of membership in the company—the amount which a member of that class is liable to contribute if the company is wound up
- the total amount that members of the company are liable to contribute if the company is wound up.

In June 2010 the AASB issued new standards (AASB 1053 *Application of Tiers of Australian Accounting Standards* and AASB 2010-2 *Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements*) on a reduced disclosure regime for non-publicly accountable for-profit private sector entities and certain entities in the not-for profit private sector and public sector. These were available for early adoption for 30 June 2010 financial statements.

The new standards introduce a second tier of reporting requirements into the Australian financial reporting

framework. This substantially reduced the burden of financial reporting for certain entities in both the private and public sectors in preparing their general purpose financial statements. The new standards introduce a regime which requires disclosures that are substantially reduced when compared with those required under the full IFRSs as adopted in Australia.

With the introduction of the reduced disclosure regime, the Australian Accounting Standards now consist of two tiers of reporting requirements that apply to general purpose financial statements:

- Tier 1: Full IFRS as adopted in Australia
- Tier 2: The reduced disclosure regime

The AASB acknowledges that whilst Tier 2 requirements would be available to all not-for-profit private sector entities and most public sector entities, regulators might exercise a power to require the application of Tier 1 requirements by the entities they regulate. Accordingly it will be interesting to monitor reporting trends in the coming year and any response from regulators.

Further information

For further information on any of these financial reporting reforms please contact your local Grant Thornton advisor or Keith Reilly, National Head of Professional Standards at keith.reilly@au.gt.com.



Important reminder – grant accounting by NFPs

Accounting for Government Grants has been a topic of interest over the past year, particularly given the various government incentives used to try to stimulate the Australian economy during the global financial crisis, such as the Building the Education Revolution (“BER”) program. Many newcomers to the not-for-profit sector often make the mistake of jumping straight to AASB120 – Government Grants for guidance on accounting for grants. However, the applicable standard is AASB 1004 – Contributions. This is an Australian specific standard to prescribe the accounting for contributions by not-for-profits and government organisations.

The main requirements of AASB 1004 are that contributions are to be measured at the fair value of the contribution received or receivable. Income from the contribution of an asset to an entity is recognised only when the following conditions are met:

- The entity obtains control of the contribution or the right to receive the contribution
- It is probable that the economic benefits will flow to the entity, and
- The amount of the contribution can be measured reliably

Contributions of assets (including cash and non-monetary assets) and the forgiveness of liabilities must be disclosed. It is important to note that there are numerous additional, specific requirements for Local Governments, Government Departments, GGSs or

Whole of Governments which are not covered in this article.

Appendix A of the standard includes key defined terms such as contributions, contributions by owners and non-reciprocal transfer, as follows:

Contributions

Non-reciprocal transfers to the entity.

Contributions by owners

Future economic benefits that have been contributed to the entity by external parties, other than those which result in liabilities of the entity, that give rise to a financial interest in the entity’s net assets which:

- (a) convey entitlement both to distributions of future economic benefits by the entity during its life, such distributions being at the discretion of the ownership group or its representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or
- (b) can be sold, transferred or redeemed

Non-reciprocal transfer

A transfer in which the entity receives assets or services or has liabilities extinguished without directly giving approximately equal value in exchange to the other party (or parties) to the transfer.

In assessing the accounting for grants, firstly judgment needs to be exercised in determining whether the grant is reciprocal. If it is assessed to be

reciprocal then the accounting treatment is determined in accordance with AASB 118 – Revenue. This is particularly the case where there are conditions attached to the grant. A contribution is non-reciprocal if it is a transfer where the entity receives assets or services, or has liabilities extinguished, without giving approximately equal value in exchange. Typically, non-reciprocal transactions involve three parties: a grantor, a grantee and a third party that benefits from the services the grantee provides under the grant rather than the usual two. A common misconception is that conditions create a reciprocal transfer. This is not the case and judgement must be applied in determining whether these conditions are sufficient to imply that the grantor is receiving approximately equal value in exchange.

If assessed to be a non-reciprocal transfer the accounting treatment for not-for-profit entities will be dependent on the answers to the three basic questions about the terms and conditions of the relevant funding agreement:

- What is the fair value of the contributions received or receivable?
- When does the entity obtain control of the contribution or the right to receive the contribution?
- What are the nature of the other terms and conditions underlying the transaction?

Typically the terms and conditions of the grant will determine whether the recognition of any liabilities (contingent

or otherwise) is required. For example, a typical condition of many grant agreements is that if the funding is not applied to the stated purpose during the term of the funding, then it is required to be repaid. In these instances, whilst the not-for-profit will have received the cash, until the funds have been applied for the required purpose the not-for-profit does not control the right to the funding and would therefore recognise a deferred income until the not-for-profit has complied with the conditions of funding.

In other instances the repayment condition may be more remote and will be contingent on a future event. For example, a BER funding agreement may require repayment of the grant if, within a specified period, the school either sells the facilities or ceases to use them for the approved purpose. In these instances the principles of AASB137 - Provisions, Contingent Liabilities and Contingent Assets would be applied with a contingent liability arising on recognition of a liability if the condition is triggered.



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