

Not for Profit Sector
Productivity Commission
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29 May 2009

Dear Sir

Contribution of the Not for Profit Sector – Productivity Commission Issues Paper April 2009

Grant Thornton Australia Ltd (Grant Thornton) is pleased to provide the Productivity Commission with its comments on the Commission's Issue Paper as it relates to the 'ways of enhancing the efficiency and effectiveness of the sector', and in particular the 'regulatory environment' and 'governance and accountability arrangements'.

Grant Thornton's response reflects our position as auditors and business advisers to listed and privately held companies, other businesses, and not for profit organisations (NFPs). This submission has benefited with input from our clients, and discussions with key constituents.

Our principal comments are as follows:

- We support a financial reporting regulatory regime that encompasses all NFPs within a single legislative act and a single regulator that has dedicated resources for regulating the financial reporting requirements of the Industry. This could be, for example, the Corporations Act (with an amended scope) and ASIC as the regulator. This would overcome inconsistencies in the current regulatory regime with some NFP organisations being subject to inconsistent Commonwealth, States and Territories legislative regimes, and enhance the efficiency and effectiveness of the sector.
- We support an exemption from the current mandatory financial reporting requirements for small NFPs which we define as having Revenues of \$1 million or less, however we note that the size test could be considered along with other factors such as where an organisation has a large number of donors contributing small amounts such as for charities, where this is a better reflection of the use of the financial report than a purely revenue test. This would align in philosophy with our 3 August 2007 Submission to

Treasury (Annexure 1) on proposals to reduce the red tape reporting burden that currently applies to unlisted public companies which included NFP organisations, where we supported a Revenue test of \$1 million. A lower than \$1 million Revenue test for say charities could be reasonable given the greater level of accountability that might be considered to apply to such entities. We do however recognise that NFPs do have governance responsibilities and we continue to support the development of appropriate reporting to constituents in order for the entities to be accountable given their status. Such reporting needs to be balanced with the costs of meeting such requirements

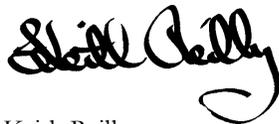
- We note that the Treasury Discussion Paper indicates that a Revenue test of \$1 million would eliminate Corporations Act reporting for around 68% of current companies limited by guarantee. We would like to see further analysis of the size of NFPs and the number of donors / members to allow a complete picture of this industry sector to be obtained prior to the determination of reporting requirements.
- Given that the majority of the users of NFP reports are purely interested in the use of funds / donations, we recommend that these entities should be exempted from the more onerous and complex current accounting standards requirements, particularly disclosure requirements.
- The Government's success in reducing unnecessary red tape costs will depend on the financial reports being relevant and useful to the users of the entity's financial reports and we believe clearer guidance in this area is necessary, particularly surrounding the applicability of all accounting standards (i.e. general purpose v special purpose financial reports and the reporting entity concept).
- In particular we believe that there should be a specific Accounting Standard and guidance applicable for NFP entities, which consolidates existing NFP paragraphs in the Australian Accounting Standards and includes additional disclosure requirements relevant to their operations. This was supported by respondents to the Grant Thornton IFRS Survey which will be published in June 2009. It is clear that the existing Australian Accounting Standards that are re-badged International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) are developed solely for profit-oriented entities and primarily with the securities market in mind, and hence do not take into account the specific characteristics of NFPs nor the users of NFP financial statements.
- For entities where stakeholders require and are prepared to see the particular organisation fund the preparation of general purpose financial reports, and in the absence of a specific accounting standard for NFPs, we support replacing the existing IFRS requirements with the proposed IFRS for Private Entities Accounting Standard that is being developed by the International Accounting Standards Board and which is expected to be released by June 2009, suitably amended by the Australian Accounting Standards Board to contain specific areas of relevance to NFPs. However, major NFP organisations should be allowed instead to adopt the IFRS that is designed for publicly accountable organisations such as listed public companies, in the absence of a specific NFP accounting standard.
- For smaller non-reporting NFP entities where there are not users who require detailed financial information in their decision to become involved through donations etc, we support a more simplified financial reporting regime. For instance the Institute of

Chartered Accountants Business Practice Guide is a good example of how a simplified financial reporting framework could operate for non-reporting NFP entities and we encourage the Australian Accounting Standards Board to consider that model with any necessary amendments to reflect the NFP industry.

- We would support an Audit of Financial Statements for NFP entities which are deemed to be large, either due to the revenue test or the number of donors / users.
- We believe that the Government's forthcoming Standard Business Reporting using XBRL technology will go a long way to overcoming the burden of providing multiple performance and compliance lodgements with various government agencies and private sector funding bodies.

Grant Thornton looks forward to discussing this Submission with the Committee. If you require any further information or comment, please contact me.

Yours sincerely
GRANT THORNTON AUSTRALIA LIMITED



Keith Reilly
National Head of Professional Standards

Appendix 1

The General Manager
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By Email: UPCcomments@treasury.gov.au

3 August 2007

Grant Thornton Association Inc (Grant Thornton Australia) appreciates the opportunity to provide comments to Treasury on the Discussion Paper 'Financial Reporting by Unlisted Public Companies'.

Grant Thornton Australia's response reflects our position as auditors and business advisers both to listed companies and privately held businesses.

In principle we are supportive of having a threshold tests mechanism, to determine whether smaller unlisted public companies should be subject to the detailed financial reporting requirements of the Corporations Act. We also continue to support the reporting entity framework that presently applies to financial reporting in Australia and note that this helps ensure that costs incurred in preparing financial information do not outweigh the benefits to stakeholders in accessing such financial information.

Our specific comments on each of the Issues raised follow.

If you require any further information or comment, please contact Keith Reilly.

Yours sincerely
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ISSUES FOR COMMENT:

- A. Do you support the introduction of a differential reporting regime based on size for companies limited by guarantee? If so, what do you consider to be the appropriate criteria (both in terms of the indicators of size and the quantum of those indicators) for differentiating between those companies that are required to report and those companies that are exempt?

Yes, we support a differential reporting regime.

We note that the thresholds test that applies to large proprietary companies (2 out of 3 - consolidated revenues \$25 million, consolidated Assets \$12.5million, 50 employees), would eliminate around 93% of such companies as detailed in Table 1 of the Discussion Paper. However given the greater level of accountability that applies to such companies that generally have a 'not-for-profit motive' as detailed in the Discussion Paper, we suggest that a lower threshold test of say \$1 million in Revenues, would be appropriate. We note that the Discussion Paper indicates that this would eliminate Corporations Act reporting for around 68% of current companies limited by guarantee.

- B. Do you believe it is appropriate to differentiate between companies limited by guarantee by the nature of their operations rather than just size? If so, what nature of operations do you believe warrants greater transparency?

No, we don't believe that differentiation should be based on the nature of operations.

- C. Do you consider that companies limited by guarantee that receive any money through grants should have financial reporting requirements? If so, can this obligation be satisfied by the company providing special purpose financial reports to the grantor rather than preparing general purpose financial reports under the Corporations Act?

No, we do not support Corporations Act financial reporting requirements for very small companies limited by guarantee. The obligation to report should be a matter for the stakeholders of those companies and will depend on the nature and size of the companies. The current Reporting Entity framework adequately covers the degree and extent of financial reporting, and where grants are made, it is up to those that make such grants and those involved in the governance of the company, to determine the cost/benefit of requiring more detailed financial information. The Corporations Act takes into account the financial size of the company (thresholds test) and under the current Accounting Standards, the financial statements would be either general purpose or special purpose.

- D. If you support some companies limited by guarantee being exempted from financial reporting, what percentage of members should be required in order to require an exempt company limited by guarantee to prepare a financial report?

We do not believe that there is a need for a small limited by guarantee company to allow a less than majority number of shareholders to determine its financial reporting requirements given that each shareholder has the same economic interest in the company and the shareholders risk is only what is usually a nominal monetary amount.

- E. If you support the retention of financial reporting requirements for all companies limited by guarantee, do you consider that there is scope to reduce the amount of financial information these companies are required to report? If so, what type of financial information do users need companies limited by guarantee to report (for example, related-party disclosures)?

The retention of financial reporting for all limited by guarantee companies is not supported. However for those companies that are required to prepare and lodge financial statements with ASIC, the Government needs to make a Public Policy decision as to the quantum of information that is needed. The AASB has proposed (IFRS for SMEs ITC 12 May 2007) that all companies that are required to prepare Corporations Act financial statements will need to adopt either IFRS or the proposed IFRS for SMEs International Accounting Standard. We note that both Standards are designated as being relevant only to general purpose financial reports. This would considerably increase the cost of preparing financial statements for smaller companies, without any significant benefit to the companies or their stakeholders.

We believe that the present Reporting Entity framework where it is up to the stakeholders to determine whether general purpose or specific purpose financial reports are needed, should remain. Otherwise the Government's success in reducing unnecessary red tape costs will not be achieved in many cases.

- F. Do you consider that there is a need to harmonise the financial reporting requirements of companies limited by guarantee and incorporated associations to provide a consistent reporting framework for not for profit entities in Australia?

Yes, we support the principle of harmonising the various States and Territories Legislation being brought into line with the Commonwealth Corporations Act requirements, and encourage the respective Governments to set up a working party so that this can be achieved.

We also remain supportive of the need for the AASB to dedicate specific resources to an Accounting Standard for the private not-for-profit sector given its importance to the Australian Economy and the Community.

- G. In order to assist in progressing this project, it would be useful to obtain an indication from companies limited by guarantee of the cost of preparing a directors' report and audited financial report as required by the Corporations Act.

We note the amount quoted in the Simpler Regulatory System Bill (Chapter 9 of the Explanatory Memorandum) of around \$60,000 for a large proprietary company and believe that this would be a reasonable indicator of the cost for a trading company limited by guarantee to produce an audited financial report. That would however be higher (say \$15,000 more) if the financial statements were prepared on an IFRS for SMEs basis (i.e. as a general purpose financial report).

- H. If some companies limited by guarantee were to be exempt from financial reporting, do you consider there is value in these companies continuing to be subject to some level of non-statutory external assurance as a means of promoting good governance? If so, what should this assurance relate to and how do you think this regime should be introduced (for example, through best practice guidelines issued by the professional accounting bodies)?

No, we do not believe that companies limited by guarantee should be treated differently to other companies. The principle behind the abolition of mandatory Corporations Act reporting and assurance requirements for small proprietary companies should likewise apply to companies limited by guarantee with it being left to the stakeholders to determine the type of reporting and assurance needed.

- I. For those companies limited by guarantee that are required to prepare financial statements, do you consider that there is a need to change the current audit requirements? If so, which aspects of the current requirements need to be reformed?

No, we do not believe that there is a need to change the audit requirements for limited by guarantee companies if a suitable revenue size test of \$1 million relieved those small limited by guarantee companies from the mandatory Corporations Act financial reporting and assurance requirements.

- J. Do you support amending the Corporations Act so that companies limited by guarantee are specifically prohibited from distributing profits to members in the form of dividends?

No, we do not support this restriction as we have seen no evidence of abuse and instead believe it is a matter of corporate governance for individual companies.

- K. Do you support the principle that all for-profit companies that have raised capital from the public should have statutory annual financial reporting obligations?

No, we do not support Corporations Act financial reporting requirements for economically insignificant unlisted public companies limited by shares. Whilst companies that are raising money from the public need at the time of raising to provide sufficient financial information so that they can attract capital, Table 2 of the Discussion Paper clearly indicates that most of the unlisted public companies limited by shares are clearly economically insignificant (44% have revenues of \$1 million or less), and few would meet the recently amended size threshold tests of revenues, assets and employee that apply to large proprietary companies. On that basis we believe it should be left to the stakeholders to determine the appropriate reporting and assurance requirements in the same way that applies to small proprietary companies, and the threshold tests should be the same for both proprietary companies and unlisted public companies that are limited by shares.

- L. Given a satisfactory mechanism to allow unlisted public companies limited by shares with a not for profit objective to convert to a company limited by guarantee is not available, would you support an equivalent differential reporting regime to that proposed for companies limited by guarantee to be established for unlisted public companies limited by shares with a not for profit focus? If so, do you support using the definition of not for profit entity in the accounting standards to determine whether a company has a not for profit focus?

We believe that the large proprietary company thresholds should also apply to unlisted public companies. Whilst we are not opposed to relief for smaller sized not-for-profit entities, we see no reason why smaller for-profit unlisted public companies that are limited by shares, should not enjoy the same benefits as apply to the small proprietary companies. We suggest that as with small proprietary companies, unlisted

public companies limited by shares should have a mechanism so that 5% of shareholders or 100 Members be able to require the company to prepare financial statements and if need be have those financial statements audited. The 100 shareholder rule recognises that an unlisted public company limited by shares might have a large spread of shareholders where 5% of the shareholding might be difficult to achieve.

- M. In order to assist in progressing this project, it would be useful to obtain an indication from unlisted public companies limited by shares of the cost of preparing a directors' report and audited financial report as required by the Corporations Act and also the number of unlisted public companies limited by shares that have a not for profit objective.

As detailed in G above, we note the amount quoted in the Simpler Regulatory System Bill (Chapter 9 of the Explanatory Memorandum) of around \$60,000 for a large proprietary company and believe that this would be a reasonable indicator of the cost for a trading public company limited by shares to produce an audited financial report. That would however be higher (say \$15,000 more) if the financial statements were prepared on an IFRS for SMEs basis (i.e. as a general purpose financial report). We do not have any meaningful statistics on the number of unlisted public companies limited by shares that have a not for profit objective.