

1 February, 2010

The Manager,
Corporate Reporting and Accountability Unit
Corporations and Financial Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: corporatereportingreforms@treasury.gov.au

Dear Sir / Madam

Corporations Amendment (Corporate Reporting Reform) Bill 2010 – Exposure draft
Companies limited by guarantee provisions

In response to the call for submissions on the *Corporations Amendment (Corporate Reporting Reform) Bill 2010*, we attach our submission on the Bill. We also refer to the PILCH submission to the Treasury 'Financial Reporting of Unlisted Public Companies' Discussion Paper dated 14 August 2007 (see <http://www.pilch.org.au/submissions/#9>).

As previously outlined, we support a reduction in the regulatory burden for companies limited by guarantee by way of the introduction of a tiered reporting regime. However, we remain of the view that accurate financial records should be kept by all (not-for-profit) companies limited by guarantee and, even at the lowest tier, basic financial and narrative information should be publicly available from filings with the regulator. We have, therefore, suggested some changes to what is reported at each tier.

We have also commented on the nature of the descriptive information to be included in the modified form of Directors' Report and the linking of the tiers to DGR status. We have identified a couple of technical issues with the wording of the draft provisions.

As general point, the timing of the Exposure Draft has, in the light of other significant inquiries, made it more difficult for us to comment. We seek an opportunity to review the Bill again in the light of the reports to be released shortly by the Henry Review and the Productivity Commission.

If you have any questions, please do not hesitate to contact us on the details below.

Yours sincerely

A handwritten signature in blue ink that reads 'Liz Morgan'.

Liz Morgan
Manager and Principal Lawyer

A handwritten signature in blue ink that reads 'Sue Woodward'.

Sue Woodward
Senior Lawyer
(Attached)

PILCHCONNECT COMMENT ON CORPORATIONS AMENDMENT (CORPORATE REPORTING REFORM) BILL 2010 – EXPOSURE DRAFT

1 ABOUT PILCHCONNECT

- 1.1 Our 2007 submission to the Treasury 'Financial Reporting of Unlisted Public Companies' Discussion Paper dated 14 August 2007¹ was made under the name of the Public Interest Law Clearing House (Vic) Inc (**PILCH**) because, in 2007, PilchConnect had not been established.
- 1.2 PilchConnect was formally launched as a discrete service under the PILCH umbrella in 2008.²
- 1.3 PilchConnect is a specialist legal service for not-for-profit community organisations (**NFPs**) based in Victoria and is one of six services operated by PILCH.³ PilchConnect has 3 equivalent full time lawyers.
- 1.4 PilchConnect provides legal services to Victorian based NFPs, including many companies limited by guarantee. Our services include free and low cost legal information, training, and legal advice (via phone). We also match eligible, public interest NFPs, who have complex legal issues with PILCH member law firms to receive free legal assistance. Our service is unique within Australia.
- 1.5 By developing as a sector-based hub of NFP legal expertise, PilchConnect is working to achieve excellent standards of governance and regulatory compliance by NFP community organisations so their economic and social contribution to Australia is maximised.
- 1.6 In effect, we are 'helping the helpers' by supporting the establishment and the effective running of well-governed community organisations. In turn, these NFPs provide crucial support and assistance to the local communities in which they operate, including services to clients and members, promoting volunteering and community well being.
- 1.7 PilchConnect works in formal partnership with the Australian Centre for Philanthropy and NonProfit Studies at Queensland University of Technology and with peak bodies such as Volunteering Victoria, Volunteering Australia and VCOSS. The service currently receives no government funding and relies on pilot funding from The William Buckland Foundation and the Legal Services Board of Victoria.
- 1.8 PilchConnect also undertakes law reform and policy work. Our submissions draw on the comprehensive inquiry data, training, advice work and case work that we provide to small-medium NFPs, assisting government to make decisions that are based on empirical evidence and practical examples. In particular, PilchConnect has made detailed submissions to the 2008 Senate Inquiry, 2008 Henry Review and 2009 Productivity Commission Research Report. These submissions have included recommendations about NFP legal structures and fundraising.⁴

¹ See <http://www.pilch.org.au/submissions/#9>

² PilchConnect is not a separate legal entity - it is a service of PILCH which is a Victorian incorporated association.

³ See www.pilch.org.au/about/

⁴ Including a follow up submission on the draft Productivity Commission Research Report. See <http://www.pilch.org.au/submissions/>

2 INTRODUCTION OF TIERED REPORTING FOR CLGs

- 2.1 We agree that the current compliance burden on small companies limited by guarantee (CLGs) is too great⁵ and the information required by the *Corporations Act* does not meet the needs of NFP stakeholders⁶.
- 2.2 We are pleased, therefore, that the *Corporations Amendment (Corporate Reporting Reform) Bill 2010 (the Bill)* reduces the compliance burden on small CLGs.
- 2.3 As submitted in 2007,⁷ we are in favour of a tiered reporting regime that only requires an audit by a registered company auditor for larger CLGs and introduces greater descriptive reporting about the company's activities.
- 2.4 We support the Bill's introduction of a 'review' by a qualified accountant (CPA, ICAA and NIA) for mid-size CLGs.

3 BASIC INFORMATION SHOULD BE FILED BY ALL CLGs

- 3.1 The Bill provides that CLG's without Deductible Gift Recipient (DGR) status and an annual consolidated revenue of below \$250,000, will not be required to prepare or lodge any financial or directors' reports (unless required by ASIC or 5% plus of members). We do not agree with this approach.
- 3.2 We remain of the view that even the smallest CLG should be required to lodge basic corporate and financial information with ASIC (or preferably an new specialist national NFP regulator) in order to ensure certain minimum information is available on a publicly accessible register for all not-for-profit (NFP) organisations incorporated as CLGs.
- 3.3 We do not believe it is good public policy to exempt these smaller CLGs (or other incorporated NFPs) from any public disclosure. Unlike small proprietary companies that are often closely held and do not enjoy income tax exempt status, there is a greater justification for public access to information about CLGs. A requirement to lodge basic financial and descriptive information helps promote good internal governance and risk management practices.
- 3.4 Our view (and the view of the majority of the participants at the expert think tank we held in 2007⁸) is that there should be a very simple form of on-line disclosure that even those on the lowest tier are required to give. The minimum disclosure should provide basic financial information (revenue, sources of funding and expenditure) and basic descriptive information about activities undertaken.
- 3.5 Without this minimum disclosure level for all CLGs, volunteers (and prospective volunteers), prospective members, prospective donors, clients and others will not have easy access to basic information about the organisation.

⁵ As outlined in the RIS, the majority of CLGs are small, at least in terms of revenue and paid employees. ASIC statistics show that more than 50% have annual revenue of less than \$500,000 yet they are currently required to prepare and publicly file annual statements that must be audited by a registered company auditor.

⁶ NFP stakeholders will want information about the mission pursued and the activities undertaken by the organisation.

⁷ See <http://www.pilch.org.au/submissions/#9>

⁸ Prior to making our 2007 submission we convened an informal think tank of a range of NFP experts. This is discussed in our 2007 submission See <http://www.pilch.org.au/submissions/#9>.

- 3.6 A large scale survey of CLGs⁹ conducted by Woodward¹⁰ (2004) found the majority of respondents were in favour of disclosing summary financial information (less were in favour of fully audited accounts) and 89% were in favour of 'disclosure of descriptive activities'.¹¹ These findings suggest that the basic minimum disclosure we have recommended would be acceptable to CLGs, even small CLGs (53% of survey respondents had annual income of under \$500,000 and 30% had income under \$100,000).¹²
- 3.7 In terms of what information should be disclosed by CLGs, it is also worth noting the findings from the research about the provision of reports to specific stakeholders:
- "In light of the limited resources available to NFP organisations, it is unlikely that a large proportion would be in a position to prepare significantly different reports for different users. Therefore, the disclosure requirements of the Corporations Act 2001 (Cth), together with accounting standards that support that law, should facilitate accountability tailored to stakeholder needs."*¹³
- 3.8 PilchConnect often receives feedback on the difficulties NFPs (including CLGs) face in meeting their corporate reporting obligations. Anecdotal feedback from our telephone inquiries and governance training supports these observations. There is a strong willingness to comply with the regulatory regime, but enormous frustration at the complexity, inconsistency and overlapping requirements. There is also concern that much of the information sought is not relevant to what members, volunteers and other stakeholders want, and that regulators require information that they never look at or use (for example, to inform the sector by way of relevant sector/sub-sector information).

Comments on particular references in the explanatory materials

- 3.9 We note para. 1.6 of the Explanatory Material refers to "member-focused companies limited by guarantee (for example, sporting clubs) having a lower level of public interest". However, even member focused CLGs often receive a public benefit (in the sense of taxation foregone) because they are income exempt bodies. There is, therefore, a public interest which we believe supports our argument in favour of minimum financial and descriptive disclosure by all CLGs, including small member-focused CLGs.
- 3.10 Our recommendation for retaining a minimum level of disclosure for small CLGs is also in line with the findings of the 2008 Senate Inquiry.¹⁴ We note page 10 of the RIS states that Option B (the proposed tiered reporting with no reporting at the lowest tier) "is consistent with the recommendations of the recent Senate Economics Committee report...". We believe that, when the full Senate report is considered, it is clear that the Senate Committee only discussed tiered reporting in relation to *audited* accounts. That is, their recommendation for tiered reporting was to introduce levels based on the revenue at which groups have to provide or not provide audited accounts, and cannot be taken as endorsement of the 'no reporting' tier outlined in the Bill.

⁹ Over 1,700 completed replies

¹⁰ The Principal Researcher and main author of the resulting research report was Susan (Sue) Woodward, who is now a Senior Lawyer with PilchConnect.

¹¹ See Woodward & Marshall, 'A Better Framework: reforming not-for-profit regulation', Centre for Corporate Law and Securities regulation, The University of Melbourne, 2004, Chp 8, in particular paras 5.5, 5.6, 5.9

¹² See Woodward & Marshall, Chp 2, page 40, para 8.1.2

¹³ See Woodward & Marshall, Chp 8, page 203, para 4.3.5

¹⁴ Senate Standing Committee on Economics *Disclosure regimes for charities and Not-for-Profit Organisations*, 14 December 2008

- 3.11 There was no recommendation or even discussion in the Senate Committee report about 'no reporting'. The overall thrust of the report (Chapter 10) and the background to how the Senate Inquiry came about,¹⁵ support the view that the Committee envisaged all groups reporting in some way, albeit with a tiered obligation for audited accounts. For example (emphasis added):

*"The committee agrees that a public website where information on all Not-For-Profit Organisations would be available to the public would assist in increasing the transparency and accountability of the Sector."*¹⁶

- 3.12 The draft research report of the Productivity Commission highlights duplication and inconsistencies in reporting requirements. The draft report states;

*"Financial reporting is an important element in building trust and allowing the public to compare NFPs, provided it is based on sound principle, is accessible and is applied proportionately depending on size of a NFP entity and the risks associated with its operations."*¹⁷

Again, there is no suggestion that some NFP organisations that currently report should be exempt from *any* financial reporting.

- 3.13 If our suggested basic reporting for the lowest tier is accepted, the current burden would still be significantly reduced for those CLGs within this tier because they would not be required (at least by the *Corporations Act*¹⁸) to prepare and lodge audited accounts.¹⁹
- 3.14 In terms of the Impact Analysis tables, we suggest that for 'costs' for Users of option B (ie, what is being introduced by the Bill) is at least -2 rather than -1. With our approach, we suggest the 'costs' for Users of a basic report is only -1 and, therefore, the option we have suggested would achieve a better overall rating.

Specific changes to Bill

- 3.15 We suggest the following amendments to the Table in (new) s 285A:

- Item 1, Column 1: small CLGs should be required to lodge a basic financial and directors report in line with our comments in para 3.4.
- Items 1 and 2, Column 1: even though the definition of small CLG excludes those with DGR status, it will make the table more user-friendly if this information is repeated in the table itself. Otherwise many will simply assume a small CLG is one with consolidated annual revenue of less than \$1 million.

- 3.16 In s 294B(4), we suggest that ASIC be required to consider the NFP nature of the CLG - in particular, whether it is volunteer run. We suggest the wording be altered to read "the date must be a reasonable one in view of the nature of the direction *and the circumstances of the company*."

¹⁵ A *Choice* article about a lack of public disclosure so that donors could compare organisations etc.

¹⁶ See para 10.50, page 112, 2008 Senate Economics Committee Inquiry Report into 'Disclosure regimes for charities and not-for-profit organisations'.

¹⁷ See p 6.22 Draft Research Report, 'Contribution of the Not-for-profit Sector', Productivity Commission, October 2009

¹⁸ The reductions in the compliance burden for CLGs will be effectively negated if government (or other) funding agreements are not changed to mirror this tiered approach. A whole of government approach is required

¹⁹ We note page 5 of the RIS refers to an estimate of an average cost \$60,000 to prepare and audit a CLG, "based on approximate costs obtained in relation to large proprietary companies".

4 DESCRIPTIVE INFORMATION ABOUT OBJECTIVES AND ACTIVITIES

- 4.1 In our 2007 submission we supported “the requirement of a short statement of what activities the organisation has undertaken and how it has worked to achieve its mission during the last reporting period”. We are pleased that the general thrust of our submission has been adopted in the Bill.
- 4.2 However, we believe that the actual wording in s 300B needs to be simplified and shortened. The references to objectives, strategy, activities and key performance indicators are very much the language of business and not always understood or used in the NFP sector. The draft Productivity Commission report highlights the difficulties faced in measuring many of the outcomes and impacts of the activities undertaken by NFPs.
- 4.3 In particular, s 300B(1)(a) is confusing. CLGs have objects (or purposes) as stated in their constitution. The reference to “short and long term objectives” is, from a company law perspective, inaccurate as there can only be the objects or objectives as set out in the constitution. To act otherwise would be to act ultra vires. Sometimes we have to remind organisations that their constitution needs to be changed to expand their objects before they proceed with a new direction/ project/ service etc. This provision would add to the confusion that already exists about the legal status of “objects”.
- 4.4 We think it is also important not to impose an unrealistic and unduly onerous burden on CLGs. Also, what will happen if a CLG does not give more than the most cursory response to this in its directors’ report – will ASIC read and follow up if they believe it does not respond sufficiently to each of paras (a) – (e)?
- 4.5 We suggest, therefore, that s 300B be amended to require the report to simply describe the company’s main activities for the period and how these activities have helped the company achieve its objects as stated in its constitution. Of course, education and training programs should always promote higher standards of governance.

5 NEED FOR FURTHER REFORMS FOR CLGs

- 5.1 Even with the enactment of this Bill, NFP groups will still have to weigh multiple and complex factors before deciding whether to incorporate as an association (under a State or Territory-based regime) or a CLG. When we discuss this issue with groups we often have to ask them ‘to imagine’ what their needs might be in many years hence. While they might be small and local now, are they likely to become multi-State or national even in the medium term? When a new group has little or no funding (often barely enough to pay the incorporation fee), it can be difficult for them to think that they may be better to incorporate as a CLG now, rather than incurring expense and difficulty by transferring in, say, 5 years. They will just feel daunted by the extra fees, a large and more complex piece of legislation and reporting to a ‘business’ regulator.
- 5.2 In this regard, we refer to the fact sheets we have developed to help those people involved in NFPs or those thinking of setting up a new NFP.²⁰ (Bear in mind they are a general guide written for non-lawyers so they do not fully highlight the complexity.) As can be seen from the fact

²⁰ See <http://www.pilch.org.au/legalstructure/>

sheet titled '*Company limited by guarantee or incorporated association*'²¹, even with the introduction of a tiered reporting regime for CLGs, there are still many factors to consider.

- 5.3 This dilemma is not something faced by business, but is a problem capable of solution.
- 5.4 We (and several key professional bodies and NFP peaks²²) remain of the strong view that a referral of powers by the States to the Commonwealth over associations and fundraising regimes is the best way to implement a nationally consistent and modernised approach for NFPs on legal structure, reporting and public fundraising activities. We must learn from the corporate law experience of failed attempts at State-based harmonisation schemes.
- 5.5 However, as an interim measure, we have outlined in our follow up submission to the Productivity Commission, the immediately possible approach of significant modernisation of the existing CLG structure.²³
- 5.6 In terms of some of the additional reforms that could improve the CLG structure for NFPs, we refer to our submission²⁴ to the 2008 Senate Inquiry, as well as that of the Law Council of Australia.²⁵ We would be happy to discuss the detail with you further.

6 LINK BETWEEN REPORTING REQUIREMENTS AND DGR STATUS

- 6.1 We note that under the Bill if a CLG has DGR endorsement it will be required to meet the mid or highest level of reporting depending on its annual revenue.
- 6.2 On balance, we agree with the 2008 Senate Inquiry on this point.

*"The committee believes that reporting... should be tiered, but also believes that it is not in the best interests of the Sector to create additional complexity by requiring those tiers to be based on charitable status or tax concessions/exemptions...Any of these options has the potential to create additional confusion, not just for Not-For-Profit Organisations, but also for members of the public who are seeking comparability between organisations...The general public may find it difficult to understand how two similar organisations with similar revenue, for example, could be on two different tiers depending on the organisations' charitable status. A straightforward method of assigning tiers is on total revenue."*²⁶

- 6.3 A policy of requiring higher level reporting by those NFPs that receive greater tax concessions is sound, but we believe it may be better to do this in the context of public fundraising laws.
- 6.4 In this regard, we note that the rationale for requiring either a 'review' or an audit by those CLGs with DGR status seems to be the assumption that DGR recipients seek tax deductible donations

²¹ See <http://www.pilch.org.au/legalstructure/#2>

²² For example, Law Council of Australia (see http://www.apf.gov.au/senate/committee/economics_ctte/charities_08/submissions/sub128.pdf), CPA Australia (see http://www.apf.gov.au/senate/committee/economics_ctte/charities_08/submissions/sub98.pdf), ACOS and VCOSS submissions to the Productivity Commission Report and Senate Inquiry.

²³ See <http://www.pilch.org.au/submissions/#1>, see paras 3.8- 3.23.

²⁴ See <http://www.pilch.org.au/submissions/#6>, in particular Heading 8.

²⁵ Law Council of Australia submission, paras 20 – 39 see http://www.apf.gov.au/senate/committee/economics_ctte/charities_08/submissions/sub128.pdf

²⁶ See paras 10.22, page 104-105, 2008 Senate Inquiry report

from the public. For example, the draft Explanatory Material states:

*“Charities, for instance, were identified as being in this category because of their public fundraising activities (for example, donation drives) and significant community involvement.”*²⁷

- 6.5 However, DGR status does not necessarily mean that the organisation will engage in soliciting donations from the public. Also, there are many more NFP organisations that engage in raising funds from the public but do not have DGR status (for example, they might raise funds via a raffle, lottery, gala dinner etc). So, if this is the reason for linking greater reporting to those NFPs with DGR status, then the fundraising regime is more appropriate (rather than corporations law).
- 6.6 We would like to reflect on this issue further in the light of the reports from both the Productivity Commission and the Henry Review (see below under heading 9).
- 6.7 In terms of the wording in the Bill, we note that the definition in s 45B needs to cover CLGs that act as trustees of DGR funds (such as overseas aid and ancillary funds that are endorsed as DGRs). Otherwise the intention of the Bill for greater reporting by those groups to which the public donate and receive a deduction will not be achieved. We suggest paragraph (b) needs to be amended to cover any company that is “not a deductible gift recipient *or trustee of a trust that is a deductible gift recipient*”.

7 COMMENCEMENT OF AMENDING LEGISLATION

- 7.1 Under s 1500, the new CLG provisions are to come into force as from 30 June 2010. While it is sensible that they be in place for the start of a new financial year, we suggest that the Explanatory Material should clarify that this commencement date means the new narrative directors’ report will relate to financial year end 30 June 2011 or calendar year end 31 Dec 2010 (rather than for reports prepared for year end 30 June 2010).

8 EDUCATION CAMPAIGN NEEDED

- 8.1 To better address the level of awareness of new compliance obligations, an education campaign should be implemented along with the proposed changes. PilchConnect is, with funding, well placed to assist the with training and development of plain language guides for NFPs, as demonstrated by our recent publication of the *Guide for Public Officers and Secretaries of Victorian Incorporated Associations*,²⁸ and our current role of updating NFPs on law reform through our monthly e-bulletin which currently has over 1,000 subscribers.²⁹
- 8.2 In this regard, we note the draft Productivity Commission report, states that it is often the case that NFP service providers are more trusted by users than government or business providers.³⁰ From our experience this is particularly so in relation to compliance and regulatory issues, as NFPs will often not wish to discuss possible breaches or general concerns with these bodies, but will be willing to seek advice from peak bodies and sector-based services such as PilchConnect.
- 8.3 We would strongly urge that the Bill be amended to include a plain language guide for CLGs (along the lines of the Guide for Small Business). If funded, we could work with a professional peak body such as Chartered Secretaries Australia Ltd and ASIC on this.

²⁷ See 1.6, page 6 draft Explanatory Material

²⁸ See www.pilch.org.au/incguide

²⁹ See <http://www.pilch.org.au/Page.aspx?ID=272>

³⁰ See, for example, General Social Survey for 2006 (ABS), at Box 4.6, of the Productivity Commission’s Draft Report

9 TIMING OF EXPOSURE DRAFT OF THE BILL

- 9.1 The Bill and related RIS were released on Friday 4 December, 2009 which was a few days after submissions to the Productivity Commission's draft report closed. The date for submissions about the Bill is 3 February 2010, which is a week or so before the Productivity Commission's final report is due to be released. The Henry Review is also likely to be released shortly.
- 9.2 Having waited more than two years for a response to the *2007 Unlisted Public Companies Discussion Paper*, it was unfortunate that this was the order of events and that, although we made a submission in 2007, we were not given direct notification about the Bill. This timing has meant that submissions (ours and several others) that commented on the draft Productivity Commission recommendation for a new NFP legal structure, have not had the benefit of being informed by consideration of the proposed reforms to CLGs.
- 9.3 In particular, had we had the opportunity to consider the Bill prior to lodging our follow up submission to the Productivity Commission, we would have explained that the reforms proposed by the Bill do not remove the need for significant further reforms to the CLG structure and/or the introduction of a new, national 'associations' NFP legal structure. While the introduction of tiered reporting for CLGs is a significant improvement, we do not believe it 'fixes' the overall issue of the need for a specialist, low cost, modern legal structure that allows NFPs to operate on a national basis by way of a single filing.³¹
- 9.4 As this submission is being made before the release of the final Productivity Commission report, we are again unable to properly consider the CLG reforms in the context of overall reform of NFP legal structures. Also, the relevance of the link between auditing and DGR status may need to be reconsidered in light of recommendations in the Henry review.
- 9.5 We seek an opportunity to review the Bill again in the light of the reports to be released shortly by the Henry Review and the Productivity Commission.

³¹ See <http://www.pilch.org.au/submissions/#1>