

SENATE STANDING COMMITTEE ON ECONOMICS
INQUIRY INTO THE DISCLOSURE REGIMES FOR CHARITIES AND
NOT-FOR-PROFIT ORGANISATIONS

BACKGROUND PAPER

Introduction

1. On 18 June 2008, the Senate referred to the Senate Standing Committee on Economics, an inquiry into the disclosure regimes for charities and not-for-profit organisations, for report by the last sitting day of November 2008.

Terms of Reference

2. The inquiry will examine:
- (a) the relevance and appropriateness of current disclosure regimes for charities and all other not-for-profit organisations;
 - (b) models of regulation and legal forms that would improve governance and management of charities and not-for-profit organisations and cater for emerging social enterprises; and
 - (c) other measures that can be taken by government and the not-for-profit sector to assist the sector to improve governance, standards, accountability and transparency in its use of public and government funds.
3. In referring this matter to the Economics Committee the Senate:
- noted the report by *Choice*¹ on charities, which was published online in March 2008, that highlights the wide variability and inconsistency in the way that charities disclose information to the public; and
 - acknowledged that the 27 recommendations from the inquiry into the definition of charities and related organisations², which reported in 2001, have not been implemented.

Important note to readers

4. As demonstrated above, the terms of reference for this inquiry are reasonably broad. This paper has been developed by the Committee's Secretariat

¹ A preview of this report is available online at <http://www.choice.com.au/viewArticle.aspx?id=106240&catId=100268&tid=100008> . The full report is a 'members access only' article.

² The recommendations from this report are listed at Appendix A. The full report can be accessed online at <http://www.cdi.gov.au/html/report.htm>

to provide a brief overview of some of the issues, in respect to governance and disclosure regimes for the not-for-profit sector, which have been raised in the above mentioned reports and in related literature. It is not intended to reflect the views of the Committee on any of the issues raised, but rather to provide guidance to individuals or organisations considering making a submission to the inquiry on the types of questions and issues that the inquiry is likely to grapple with.

5. It is also important to note that it is **not** the intention of the Committee to limit the inquiry to the issues and questions raised in this paper. The Committee welcomes any submission that addresses the terms of reference for the inquiry, regardless of whether or not it addresses the issues canvassed in this background document.

The not-for-profit sector in Australia

6. The not-for-profit sector in Australia, which includes charities along with a range of other entities, such as churches, sporting organisations, advocacy groups, community organisations, co-operatives, trade unions, trade and professional associations, chambers of commerce, welfare organisations and service providers, is a significant sector of the Australian economy and makes a marked contribution to civil society.

7. According to the National Roundtable of Nonprofit Organisations³, there are as many as 700,000 not-for-profit organisations in Australia, most of which are very small and dependent on the voluntary commitment of members. Around 380,000 of these are incorporated in some form or another (ie. they have a legal identity independent from their members). In 1999-2000 the not-for-profit sector accounted for approximately 6.8% of Australians in employment and contributed 3.3% of Australia's GDP (4.7% when the value of volunteer labour is included). In 2003, 86% of adults belonged to at least one not-for-profit association, with 48% belonging to three or more.

8. Despite the size of this sector, and its centrality to the well-being of society, its contribution often goes unrecognised and it remains largely unregulated.

Current regulatory regimes

9. There is no single regulatory regime for not-for-profit organisations in Australia. According to the Nonprofit Roundtable:

At present there are more than twenty different ways to incorporate a nonprofit organisation. This variety is a product of both a variety of specialist forms of incorporation (eg for trade unions, parent associations), and the existence of a dual state/federal regime. There are eight forms for incorporating as an association and six as a cooperative.

³ National Roundtable of Nonprofit Organisations, *The Nonprofit Sector in Australia: A Fact Sheet*, Downloaded on 2 July 2008 from www.nonprofitroundtable.org.au

10. Some (generally larger) not-for-profit organisations, because of their corporate structure, come under the purview of the Australian Securities and Investments Commission and, as such, are subject to the same reporting and auditing requirements that apply to for-profit companies.⁴ Other not-for-profit organisations are incorporated associations or trusts. Incorporated associations are governed by state and territory based legislation which differs from one jurisdiction to another, 'both in nature and enforcement.'⁵ According to Murray, such associations 'are lightly regulated with few reporting requirements.'⁶

11. A number of not-for-profit organisations may also have been established by statute, for example the Cancer Council Victoria was established by the *Cancer Act 1958* (Vic). In these cases, the operation of the organisation, including reporting requirements, is determined by the Act.

12. Not-for-profit organisations who undertake fundraising activities are also subject to state and territory fundraising legislation⁷, which may specify a variety of reporting and disclosure requirements. This adds an additional level of complexity for organisations undertaking fundraising in more than one jurisdiction.

Concerns about the not-for-profit sector

13. A number of concerns have been expressed about the way in which the not-for-profit sector operates in Australia. These include:

- a lack of transparency about the way in which public or donated funds are spent; and
- lack of accountability, despite the fact that the not-for-profit sector is a major provider of services to the public.

Lack of transparency

14. A survey conducted by *Choice* found that 81% of respondents did not know what proportion of their charitable donation reached their favoured charity's beneficiaries, yet 94% considered it important to have access to that information. The survey found wide variability and inconsistency in the way that charities communicate key information to donors. In some cases, such information was not publicly available at all, as some charities did not publish their annual reports or financial accounts.⁸

⁴ Murray, A., *One Regulator One System One Law – The Case for Introducing a New Regulatory System for the Not for Profit Sector*, July 2006, p.11.

⁵ Murray, A., (2006). p. 48.

⁶ Murray, A., (2006). p. 48.

⁷ See the following Acts for details: *Collections Act 1966 (Qld)*; *Charitable Fundraising Act 1991 (NSW)*; *Charitable Collections Act 2003 (ACT)*; *Fundraising Appeals Act 1998 (Vic)*; *Collections for Charities Act 2001 (Tas)*; *Public Collections Act (WA)*; and the *Collections for Charitable Purposes Act 1939 (SA)*.

⁸ Choice, *Charities*, downloaded from www.choice.com.au on 2 July 2008, pp. 1-13.

15. The *Choice* report, which also included a survey of charities, also found that there was no uniform accounting or reporting standards for charities, so even when charities did make available information about how donations were distributed, this information did not necessarily allow a comparison to be made across different entities, because different approaches and definitions may be used. As one respondent put it:

*Charities pluck numbers out of the air for their fundraising costs. There's no agreement about what constitutes administration costs. Some will say it's only the people in your fundraising department. Others might include IT, HR, marketing departments... there's no consistency.*⁹

16. According to Murray:

*Currently many NFPs are not legally obliged to report to donors, service recipients or to an independent auditing body. There is no prospectus-type or financial report obligation to give a detailed breakdown to donors of how their money is or was going to be used – how much will be used for administration or marketing and how much will be given directly to the cause that the donor wants to be supported. Some NFPs do provide this information to maintain good relations with donors. However there is no legal obligation to do so.*¹⁰

17. This assertion is supported by a survey of 448 charities undertaken by *Givewell*, which found that only 54% of these charities publicly disclosed their fundraising costs.¹¹

18. It is not only disclosure of fundraising dollars that is at issue. It is also argued that it is in the public interest for not-for-profit organisations to be more transparent and accountable, as they attract significant public funds through tax concessions. While the extent of these tax concessions is unknown, the Treasury estimates that, in 2006-07, total concessions, benefits and incentives provided through the tax system to taxpayers and beneficiaries amounted to approximately \$50.12 billion.¹² It is unclear what proportion of this \$50.12 billion worth of concessions, benefits, and incentives relate to charities or other not-for-profit organisations, as the *Statement* does not provide a breakdown into these categories.

19. According to the Nonprofit Roundtable:

There are a great variety of concessions given by different levels of government, each to a variety of nonprofit organisations. It is impossible to find any set of principles underpinning the legislation that designates these concessions. There are no clear links between the concessions provided and public disclosure requirements. Not surprisingly, in such an environment regulation is confusing, contradictory and often unfair.

⁹ Choice, *Charities*, p. 3.

¹⁰ Murray, A., (2006), pp. 31-32.

¹¹ cited in Choice, *Charities*, p. 7.

¹² Commonwealth of Australia, *Tax Expenditures Statement 2007*, released 25 January 2008, p. 8.

20. Concerns about current disclosure regimes by not-for-profits have resulted in calls for not-for-profit organisations, particularly charities, to be subject to standardised accounting and reporting requirements, thus ensuring that stakeholders can make some assessment of their effectiveness and efficiency in achieving their stated goals.¹³

21. It has been argued that improved disclosure regimes may serve to increase confidence in, and funding to, the sector. For example, in 1995 the Industry Commission found that:

*Accountability is an important operational issue for all Community Social Welfare Organisations (CSWOs). Their supporters and the general public expect, and are entitled to, information about the finances and operations of CSWOs in return for their donations, voluntary activities and taxation exemptions and concessions. Improved confidence that funds are being used appropriately by CSWOs can potentially increase the overall fundraising resources available to the sector.*¹⁴

22. The preliminary findings in February 2005 of *Giving Australia* also found that:

*businesses wanted non-profits to be more accountable and transparent for funds received: there had been an erosion of trust... that money given would be used for its stated purpose.*¹⁵

23. Others have argued, however, that changes to disclosure regimes, requiring all not-for-profit organisations to be subject to standardised accounting and reporting requirements, would seriously disadvantage small organisations, who may not have the human resources and knowledge base to comply with such requirements. In addition, a study by the Social Economy Executive Education Network, while supportive of improved transparency and accountability in the not-for-profit sector, notes that:

*...transparency alone is not enough. The sector's stakeholders need to become more sophisticated in their understanding of the sector to ensure that any increased transparency doesn't result in negative backlash. For example, there is no point encouraging organisations to disclose their overhead costs or to argue for the need for their greater investment in capacity if naïve funders will view this negatively and reduce their financial support.*¹⁶

¹³ See for example, Choice, *Charities*; Pro Bono Australia, *Not For Profit News Service*, Issue – 2007-06-04; Murray (2006).

¹⁴ Charitable Organisations in Australia, Industry Commission, Report No. 45, June 1995, cited in Murray, (2006), p. 13.

¹⁵ *Giving Australia: Research on Philanthropy in Australia*, Summary of Preliminary Qualitative Findings, 2005, cited in Murray, (2006). p. 14.

¹⁶ Social Economy Executive Education Network, *Contrary and Congruent Views on Leadership and Management in the Australian Social Economy*, November 2007, p. 5.

Questions for consideration

- i. Are current disclosure regimes for not-for-profit organisation adequate?
 - If so, why (taking into account concerns such as those expressed by *Choice*)?
 - If not, why not?
- ii. What would be the potential advantages and disadvantages for not-for-profit organisations of moving towards a single national disclosure regime? How might any disadvantages be minimised?
- iii. Would a standardised disclosure regime assist not-for-profit organisations who undertake fundraising activities, and who operate nationally, to reduce their compliance costs if it meant that they would only have to report on fundraising to a single entity (rather than reporting to each state and territory)?
- iv. If there was to be a nationally consistent disclosure regime, should it apply across all not-for-profit organisations or should different regimes apply to different parts of the sector? For example, should charities be treated differently than other not-for-profit entities?
- v. If different regimes were to apply to different parts of the sector, how would this be determined and why? For example, would it be based on classifications – ie., as a charity or deductible gift recipient – or would different regimes apply to different organisations based on their annual financial turnover or staffing levels (or some other proxy for size and/or capacity)?

Lack of accountability

24. Linked to concerns expressed about lack of transparency of some not-for-profit groups is a broader concern about poor accountability within the sector.

25. This was a recurrent theme in the study conducted by the Social Economy Executive Education Network into views on leadership and management in the 'social economy'¹⁷:

Innovative leaders in the focus groups and thought leadership forums repeatedly expressed the view that there was increasing accountability required of the sector. They spoke of the need for better measures of impact. And participants from foundations commented on the need for better processes for application and disbursement of funds that predicted

¹⁷ Note: this study looked at the 'social economy' rather than just the not-for-profit sector. The social economy was defined as: "the production of goods and services not solely provided by the non-profit sector, but also, in some cases by private enterprises with shareholder agreements that force the majority of shareholders to agree to social objectives undertaken by the firm... the 'Social Economy' is a broader concept than the non-profit sector".

greater social impact. Recent discussions within the Social Economy speak about the "rating of organisations and benchmarking within (and perhaps across) the sector."¹⁸

26. They argue for a 'holistic' approach to accountability that might include:

- *Statements of an organization's mission, its purpose, its design (grant to earned income ratios) and governance, alliances and partnership, codes of conduct and policies.*
- *Statements of internal operations, employment and "discounted" wage structures, remuneration of directors and managers, sustainability strategies, performance indicators, program activities etc: and*
- *Statements about impact and the effectiveness of projects and programs, public policy, reporting, representation and advocacy, etc.*

All these three areas contribute in a systematic way to greater transparency in the sector.

Calls for regulatory reform

27. Concerns about lack of transparency and accountability have led to calls for fundamental reform of the regulation of the not-for-profit sector in Australia. This has largely taken the form of calls for the establishment of a single regulatory entity at the national level, such as those established in the United Kingdom¹⁹ and New Zealand.²⁰

28. For example, the *Inquiry into the Definition of Charities and Related Organisations* recommended that the Australian Government 'seek the agreement of all State and Territory Governments to establish an independent administrative body for charities and related entities, and to the legislative changes necessary for its establishment.'²¹

29. Similarly, former Democrat Senator Andrew Murray has proposed that consideration be given to establishing a simplified regulatory framework to apply to both not-for-profit entities, including charities, and small for-profit businesses, with the regime to be administered by a Registrar of Incorporated Organisations.²²

¹⁸ Social Economy Executive Education Network, (2007), p. 39.

¹⁹ Information on the role and function of the Charity Commission for England and Wales is available from <http://www.charity-commission.gov.uk/>

²⁰ Information on the role and function of the New Zealand Charities Commission - Komihana Kaupapa Atawhai is available from <http://www.charities.govt.nz/>

²¹ *Report of the Inquiry into the Definition of Charities and Related Organisations*, June 2001.

²² Murray, A., *A proposal for simplifying the legal form and regulation of small for-profit businesses and not-for-profit entities*, April 2008. Downloaded on 2 July 2008 from <http://www.andrewmurray.org.au/documents/539/FPNFP-IO%200408.pdf>

30. Calls for changes to the regulatory regime applying to the not-for-profit sector are also coming from within the sector itself. The Nonprofit Roundtable argues that:

The precarious scaffold of regulation provided by a mixture of common law, state, federal and local government laws is not a robust framework of nonprofit organisation regulation that can easily accommodate changes in our social and economic environment.

A fundamental review is necessary, as the complexity and rigidity of Australia's current nonprofit laws place a costly compliance burden while failing to adequately protect funders and donors and other stakeholders such as volunteers and beneficiaries. The evidence suggests that the current scaffold constrains small nonprofit organisations while failing to take account of the complexity, but also the professionalism and national focus of many large nonprofit enterprises. The imposition of unnecessary costs inhibits the formation of nonprofit organisations and increases costs to the community, governments and consumers.

The regulatory framework must enable the nonprofit sector to grow and adjust to rapid change. For example, nonprofit regulation needs to be able to adapt to such developments as electronic commerce, social entrepreneurship, funding innovations and an aging population.

31. However, as was noted in the discussion about the need for increased transparency, not all in the not-for-profit sector are supportive of regulatory reform, with some arguing that small organisations would be hampered by any additional regulatory or administrative burden.²³

32. While there have been consistent calls for a National regulator, there is some question about where such a regulator might be located. Possibilities that have been canvassed include:

- within the Australian Tax Office, although Murray argues that it 'is a good administrative principle that the tax collector should not be burdened with non-tax regulation... there is a great deal of merit in having a separate independent entity which regulates the NFP sector which is unrelated to the ATO or the sector itself'²⁴;
- as a separately resourced division of the Australian Securities and Investment Commission (ASIC), which already has a role to play in regulating not-for-profit organisations that are companies limited by guarantee. This would lead to economies of scale but concerns have been expressed that ASIC is not particularly user friendly to the not-for-profit sector²⁵; and
- a stand alone regulatory body, which would be independent of government.

²³ Murray, A (2006), p. 47.

²⁴ Murray, A (2006), p. 35.

²⁵ Murray, A (2006), pp. 49 and 58.

Questions for consideration

i. Does there need to be regulatory reform of the not-for-profit sector?

If not:

- Why not?
- Are there alternative (non regulatory) measures that might be taken by government and the not-for-profit sector to address some of the concerns raised by groups such as *Choice* about the governance, standards, accountability and transparency of not-for-profit organisations who use public and/or government funds?
- Who should be responsible for progressing and/or funding these measures?
- How might the uptake of any such measures be monitored?

If so:

- What should be the objectives of reform?
- Are their minimum requirements that must be met in order for a national regulatory system to be worthwhile?
- Should regulatory reform apply to the whole not-for-profit sector, or only to segments of the sector? For example, to charities; to bodies receiving public funds, whether through grants or tax concessions; to bodies with a financial turnover about a specified threshold etc?
- Where should the impetus for reform come from? Who should drive reform?
- What sort of consultation should be conducted on the nature of any regulatory reform? How could input be facilitated from across the broad range of organisations who comprise the not-for-profit sector?
- Are their particular models of regulation and/or legislative forms that would be useful, in the Australian context, in improving governance and management of charities and not-for-profit organisations and in catering for emerging social enterprises? What are the perceived advantages and/or disadvantages of these models?

ii. Should there be a single national regulator for the not-for-profit sector?

If not,

- Why not? What would be the disadvantages in having a single national regulator?

If so:

- Should a national regulator be responsible for the entire not-for-profit sector or only the charitable sector?
 - Should the regulator be independent of government?
 - Where would the regulator be best located? For example, as a stand alone agency or located within an existing institution, such as the Australian Securities and Investment Commission.
 - What would be the role of a national regulator? For example, should it have an:
 - educative/advisory role?
 - enforcement role?
 - mediation/dispute resolution role?
 - Should a national regulator be responsible for making decisions about charitable status?
 - How should any national regulator be funded? For example, by the federal government, by federal, state and territory governments, on a cost recovery basis?
- iii. Should there be a single, specialist, legal structure for the not-for-profit sector?

If not,

- Why not? What would be the disadvantages in having a single, specialist, legal structure for the not-for-profit sector?

If so, would this be best achieved through:

- A national legislation scheme, whereby current national and state and territory laws relating to the not-for-profit sector are harmonised into uniform law?; or
- The referral of powers from the states and territories to the Commonwealth, allowing for incorporation of current laws relating to the regulation of the not-for-profit sector, for example, incorporations Acts and fundraising Acts, into Commonwealth legislation?
- What should be the minimum features of any legal structure?

**REPORT OF THE INQUIRY INTO THE DEFINITION OF CHARITIES AND
RELATED ORGANISATIONS JUNE 2001**

SUMMARY OF RECOMMENDATIONS

Recommendation 1

That the term 'not-for-profit' be adopted in place of the term 'non-profit' for the purposes of defining a charity.

Recommendation 2

That the term 'entity' be adopted to describe charities, and that the definition of 'entity' include: a body corporate; a corporation sole; any association or body of persons whether incorporated or not; and a trust;

and exclude: an individual; a political party; a partnership; a superannuation fund; and the Commonwealth, a State, or a body controlled by the Commonwealth or a State.

Recommendation 3

That a charity must have a dominant purpose or purposes that are charitable, altruistic and for the public benefit. If the entity has other purposes, those purposes must further, or be in aid of, the dominant purpose or purposes, or be ancillary or incidental to the dominant purpose or purposes.

Recommendation 4

That an entity be denied charitable status if it has purposes that are illegal, are contrary to public policy, or promote a political party or a candidate for political office.

Recommendation 5

That the activities of a charity must further, or be in aid of, its charitable purpose or purposes. Activities must not be illegal, contrary to public policy, or promote a political party or a candidate for political office.

Recommendation 6

That the public benefit test, as currently applied under the common law, continue to be applied; that is, to be of public benefit a purpose must:

- be aimed at achieving a universal or common good;
- have practical utility; and
- be directed to the benefit of the general community or a 'sufficient section of the community'.

Recommendation 7

That the public benefit test be strengthened by requiring that the dominant purpose of a charitable entity must be altruistic.

Recommendation 8

That self-help groups which have open and non-discriminatory membership be regarded as having met the public benefit test.

Recommendation 9

That where closed or contemplative religious orders regularly undertake prayerful intervention at the request of the public, their purposes be held to have met the public benefit test.

Recommendation 10

That public benefit does not exist where there is a relationship between the beneficiaries and the donor (including a family or employment relationship); and that this principle extend to purposes for the relief of poverty, which the common law currently regards as being exempt from the need to demonstrate public benefit.

Recommendation 11

That there be no requirement that charitable purposes fall either within the 'spirit and intendment' of the Preamble to the Statute of Elizabeth or be analogous to one or more of its purposes.

Recommendation 12

That the principles enabling charitable purposes to be identified be set out in legislation.

Recommendation 13

The Committee has considered five options for defining charitable purpose as set out in Chapter 16. It concludes that three options are viable, but recommends the following preferred option (Option 5):

Charitable purposes shall be:

- the advancement* of health, which without limitation includes:
 - the prevention and relief of sickness, disease or of human suffering;
- the advancement* of education;
- the advancement* of social and community welfare, which without limitation includes:
 - the prevention and relief of poverty, distress or disadvantage of individuals or families;

- the care, support and protection of the aged and people with a disability;
- the care, support and protection of children and young people;
- the promotion of community development to enhance social and economic participation; and
- the care and support of members or former members of the armed forces and the civil defence forces and their families;
- the advancement* of religion;
- the advancement* of culture, which without limitation includes:
 - the promotion and fostering of culture; and
 - the care, preservation and protection of the Australian heritage;
- the advancement* of the natural environment; and
- other purposes beneficial to the community, which without limitation include:
 - the promotion and protection of civil and human rights; and
 - the prevention and relief of suffering of animals.

* Advancement is taken to include protection, maintenance, support, research, improvement or enhancement.

Recommendation 14

That the definition of religion be based on the principles established in the Scientology case, namely:

- belief in a supernatural Being, Thing or Principle; and
- acceptance and observance of canons of conduct in order to give effect to that belief.

Recommendation 15

That the encouragement of sport and recreation for purposes of amusement or competition not be a charitable purpose, it being noted that the advancement of health, education, social and community welfare, religion, culture or the natural environment through the encouragement of sport and recreation would be considered a charitable purpose.

Recommendation 16

That the care, support and protection of children and young people, including the provision of child care services, be considered a charitable purpose.

Recommendation 17

That charities be permitted neither to have purposes that promote a political party or a candidate for political office, nor to undertake activities that promote a political party or a candidate for political office.

Recommendation 18

That commercial purposes should not deny charitable status where such purposes further, or are in aid of, the dominant charitable purposes or where they are incidental or ancillary to the dominant charitable purposes.

Recommendation 19

That the current approach of denying charitable status to government bodies be maintained. The Committee agrees with the principles set out in the Fire Brigades case and the Mines Rescue case for determining whether an entity is a government body, namely that the entity is constituted, funded and controlled by government.

Recommendation 20

That there be a definitional framework to distinguish altruistic entities from other not-for-profit entities.

Recommendation 21

That in the recommended definitional framework, the category of public benevolent institution be replaced by a subset of charity to be known as Benevolent Charity, that is a charity whose dominant purpose is to benefit, directly or indirectly, those whose disadvantage prevents them from meeting their needs.

Recommendation 22

That the framework recommended in this Report should not include the terms 'religious institution', 'scientific institution' and 'public educational institution', as altruistic entities with religious, scientific or public educational purposes and that are for the public benefit are covered by the categories in the recommended framework.

Recommendation 23

That there be a category, known as 'Altruistic Community Organisations', that are entities that are not-for-profit and have a main purpose that is altruistic. That is, they can have secondary purposes that are not altruistic, and that do not further, or are not in aid of, or are not incidental or ancillary to, their main altruistic purpose.

Recommendation 24

That the Government seek the agreement of all State and Territory Governments to the adoption nationally of the definitional framework for charities and related entities recommended in this Report.

Recommendation 25

That the Government seek the agreement of all State and Territory Governments to establish an independent administrative body for charities and related entities, and to the legislative changes necessary for its establishment.

Recommendation 26

If an independent administrative body is not established:

- that the Government set up a permanent advisory panel, including members from the charitable and related sector, to advise the Australian Taxation Office on the administration of the definitions relating to charities and related entities, and to advise the Government on the definitions of charity and related terms; and
- that the endorsement processes currently undertaken by the Australian Taxation Office be extended to include the endorsement of charities and related entities in order to access all the taxation concessions to which they are variously entitled.

Recommendation 27

That the Government commit to a comprehensive public information and education campaign to inform the charitable and related sector of any changes arising from its consideration of this Report.