

Chapter 3

Reforming the Sector

3.1 This chapter explores the call for reform within the Third Sector, which will increase transparency and accountability, and analyses the terms 'transparency' and 'accountability' as they relate to the legal structures used by Not-For-Profit Organisations in Australia.

3.2 The Choice article, as discussed in Chapter 1, raised several issues surrounding the operation of charities in Australia, including: a lack of transparency in the way in which public or donated funds are spent; and lack of accountability, despite the fact that Not-For-Profit Organisations are major providers of services to the public.

3.3 The survey conducted by Choice found that 81 per cent of respondents did not know what proportion of their charitable donation reached their favoured charity's beneficiaries, yet 94 per cent 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.¹

3.4 The Choice report 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.²

3.5 The majority of submitters to this inquiry chose to comment on the transparency and accountability of Not-For-Profit Organisations as highlighted by the Choice article, and on other reforms to the Sector itself which would increase transparency and accountability.

1 Choice Magazine, *Charities*, March 2008, <http://www.choice.com.au/viewArticle.aspx?id=106240&catId=100268&tid=100008> (accessed 23 September 2008).

2 Choice Magazine, *Charities*, March 2008, p. 3. <http://www.choice.com.au/viewArticle.aspx?id=106240&catId=100268&tid=100008> (accessed 23 September 2008).

Transparency and accountability

Transparency

3.6 Transparency and accountability requirements are the same for all companies limited by guarantee under the *Corporations Act 2001*, and these requirements are administered by the Australian Securities and Investments Commission (ASIC).³ (Further discussion on the issue of organisations' legal structures is found in Chapter 7.) No differentiation is made as to whether those organisations are for-profit or not-for-profit. This Inquiry heard that transparency and accountability should be defined separately for for-profits and not-for-profits given their different objectives. Whereas the aim of businesses is to maximise profits for distribution to shareholders, for Not-For-Profit Organisations:

Their *raison d'être* is cause related rather than profit incentive with their two main functions being operational (providing services) and advocacy (giving voice to the cause).⁴

3.7 A traditional definition of 'transparency' is something easily understood; open; frank; or candid.⁵ This is achieved for the business sector under legislation in Australia through the provision of open and detailed financial records provided to the regulator. However, the committee received a number of submissions which indicated that 'transparency' should be defined more broadly for Not-For-Profit Organisations:

The starting point is transparency of purpose, clarifying why the organisation exists, what its objectives are and what the measures of achievement are. It also means transparency of process so that all stakeholders understand how things are done as well as why.⁶

Accountability

3.8 The majority of submitters believe that accountability is important for Not-For-Profit Organisations. Chartered Secretaries Australia believes that accountability:

...means asking the questions: Who is responsible and to whom? What are they responsible for? What are the consequences if the rules are violated? It is a normal part of the exercise of responsibility. It is a reporting mechanism enabling those conferring responsibility to monitor its exercise.

3 Many ASIC registered Not-For-Profit companies are companies limited by guarantee, which are public companies. Public companies are held to higher levels of regulation than private companies such as PTY LTD family and/or small business ventures. Among other regulatory provisions, public companies must hold an Annual General Meeting, deal with certain disclosures in their annual report and have more restrictive regulation of directors' financial benefits. Large stock market listed corporations are also classified as public companies.

4 Wesley Mission Sydney, *Submission 41*, p. 3.

5 *The Macquarie Dictionary*, 2nd Revised Edition, 1987.

6 Chartered Secretaries Australia, *Submission 17*, p. 1.

3.9 For the Sector as a whole to achieve accountability as defined by CSA, a regulator would be required. While some Not-For-Profit Organisations are regulated by ASIC or a state or territory government, Mr Andrew Murray notes that 'currently many NFPs are not legally obliged to report to donors, service recipients or to an independent auditing body'.⁷

Donor opinion

3.10 The committee received several submissions to this inquiry from donors wishing to make comments in relation to those issues expressed within the Inquiry's terms of reference. Mr Richard Stradwick, a regular donor to a number of charities and related organisations, believes that donors should have access to the following information:

1. What are the objectives of the organisation?
2. How does the organisation intend to achieve these objectives?
3. Who are the people responsible for the governance of the organisation?
4. Where do the organisation's funds come from?
5. Where are the funds used?⁸

3.11 According to Mr Stradwick:

The fact that donors may choose not to seek the information is not significant. At least it is available and anyone who wants to see it should be able to do so. Moreover if this information is available, the organisation can be held to account for its achievements and failures.⁹

Committee View

3.12 The committee believes that the terms 'transparency' and 'accountability' merit different interpretation by Not-For-Profit Organisations - particularly in relation to smaller organisations - than by the Business Sector. However, the committee is aware that the issue of proper transparency and accountability is comprised of many overlapping issues, all relating to the regulation of the Sector as a whole.

Is reform necessary?

3.13 In responding to a question about whether regulatory reform was needed, the Australian Evangelical Alliance replied:

In our view the answer is YES – and it should apply right across the third sector. All parties involved – the NFP sector itself, the state and federal

7 Murray, Andrew, *One Regulator One System One Law - The Case for Introducing a New Regulatory System for the Not for Profit Sector*, July 2006, p. 31.

8 Mr Richard Stradwick, *Submission 138*, p. 3.

9 Mr Richard Stradwick, *Submission 138*, p. 3.

governments as well as representatives of the community and business – should work together in consultation to bring necessary reforms to the sector which would continue to grow the confidence and trust of the stakeholders in the future of this vital sector within our community here in Australia.¹⁰

3.14 The Heart Foundation also believes that there is an urgent case for reform:

There is a pressing case for rationalising the many hundreds of laws and regulations that apply to operation and activities of charities and non-for-profit organisations, many of them making for unnecessary complexity and sometimes deterring charities from undertaking certain legitimate fundraising activities, denying them access to important sources of funding.¹¹

3.15 Professor Mark Lyons agrees that the current arrangements are a problem because, in the eyes of the public, the current system:

- Reinforces the low level of public understanding of the sector and reduces the movement to informed giving;
- Makes it almost impossible to obtain information of a comparative kind, to allow donors or grant makers to make informed choices about their giving;
- Makes it impossible to discover who the backers of think tanks/advocacy orgs are or to test claims by advocacy organisations about their representativeness.¹²

3.16 The committee notes that there is a precedent within the business sector for reform. The goals of the current COAG Reform Agenda are to 'address the challenges of boosting productivity, increasing workforce participation and mobility and delivering better services for the community. This reform agenda will contribute to the broader goals of social inclusion, closing the gap on Indigenous disadvantage and environmental sustainability'.¹³ Despite reform being undertaken that will mainly benefit the business sector, the committee heard that 'multiplicity of NFP regulation and regulators causes inconsistencies' resulting in a far more complex regulatory system than is in existence for business.¹⁴

3.17 Submitters to the inquiry saw no reason why the business sector should receive preferential treatment:

10 Australian Evangelical Alliance, *Submission 37*, p. 6.

11 The Heart Foundation, *Submission 165*, p. 3.

12 Professor Mark Lyons, *Submission 67*, p. 8.

13 Council of Australian Governments, *Meeting 3 July 2008*, http://www.coag.gov.au/coag_meeting_outcomes/2008-07-03/index.cfm (accessed 6 November 2008).

14 PilchConnect, *Submission 129*, p. 3.

Reform is urgently needed. As successive governments have committed to reducing the regulatory burden on business, so it needs to give equal priority to working with the Non Profit Sector to reform its operating environment.¹⁵

Committee View

3.18 The committee agrees that the size of the Sector and the current complexity of legislation and regulations mean that the regulatory system for Not-For-Profit Organisations should be immediately reviewed. The committee believes that the complexity inherent in the current regulatory system forms a significant barrier to transparency.

15 Australian Council of Social Service, *Submission 109*, p. 2.