

## **Senate Standing Committee on Economics Inquiry into Disclosure regimes for Charities and not-for-profit organisations**

### **SVA's perspective on the existing disclosure regimes – Part 1**

Although SVA has formed opinions on many aspects of the non-profit sector over the years, rather than trying to make comments on too many things we would rather offer observations and possible solutions only on those aspects where we believe we have strong views and where we consider ourselves experts. These are as follows:

#### **Obtaining DGR Status**

We believe that obtaining DGR status should be more administratively streamlined. For those charities seeking DGR status that fit an existing and standard tax endorsed category the current process seems to work satisfactorily. However, for those who don't fit a standard category and need to further "argue their case" or go down the arduous specific listing route, the process is cumbersome and could be improved considerably.

We believe the granting of DGR status should be done outside of the ATO – perhaps a panel of suitably qualified people who have a good understanding of the charitable sector. We believe that a review panel should have the power to grant DGR status for those who do not fit a standard category or who wish to argue their case more. We believe this should replace the specific listing process, which is essentially a political process which can take many months (or years) to achieve. A suitably qualified and empowered panel should operate to consider submissions in a timely manner.

We also believe the DGR process should be streamlined so that all organisations seeking DGR go through the one process/methodology/entry point, as opposed to the current regime where different groups have different processes e.g. those associated with the arts go through a Cultural Register via the Minister for Arts; those associated with the environment go through an Environmental Register via the Minister for the Environment; others go via the ATO etc.

Overall, streamlining the DGR process should save considerable time, reduce barriers to entry and encourage innovation.

#### **Monitoring and transparency of DGRs**

We believe that it is a significant benefit to a charity to have DGR status. It is a benefit given by the Government on behalf of taxpayers and as such there should be appropriate governance around maintaining the benefit. We believe there needs to be greater oversight and expectations of charities that have DGR status. This could be done in three ways:

- Those with DGR status should be required to report various information into a publicly available national database on a yearly basis by a set date, otherwise their DGR status should be suspended (we believe this would not be difficult to establish using standard formats and online technology; it is an area of considerable interest to SVA). This is discussed further below.
- The Government should make available on an annual basis (and by a set date) timely statistics about DGRs, obtained from information lodged by taxpayers in their income tax returns and obtained from summarised information from the abovementioned database. The statistics should also pick up information lodged by Prescribed Private Funds with the ATO. This is discussed further below.
- The Government should apply more resources to do random audits of those groups with DGR status to judge whether such groups should continue to have DGR status

#### **Reporting by DGRs**

One of our major concerns about the non profit sector centres on the lack of requirements for transparency in reporting, particularly in relation to program outcomes/impact. This has significant negative impacts on the effective delivery of services by the sector and the willingness of philanthropists to support the sector.

Transparency is also a mechanism that assists the good organisations to prosper and the less effective organisations to wither – something which we believe is a healthy “cleansing” mechanism.

As stated above, we believe those organisations with DGR status should be required to report various information into a publicly available national database on a yearly basis by a set date, otherwise their DGR status should be suspended. This information (perhaps called an Annual Report) should be both qualitative and quantitative, in a set format and set length, and provided on an annual basis by a certain date. While we believe significant thought needs to be given to exactly what type of information should be required to be provided in the Annual Report, we believe it would at least encompass the following from the perspective of a social organisations (being the charitable groups that SVA has specialised in working with):

- An outline of an organisation’s purpose and what it is trying to achieve, including a definition of successful outcomes. It should explain why the organisation exists and what problem(s) it is trying to address or solve.
- Evidence of program activity creating outcomes that connect to the organisations purpose. As an aside, we note that many non-profit Annual Reports today are dominated by ”busyness” indicators which demonstrate activity but fail to show what outcomes and impact are being generated.
- A survey of the environment in which the non profit is operating would be instructive. This is the equivalent of the market-and-competitor analysis. It might show where the organisation fits in providing services relative to others working in a similar area, and highlight what it does well, who it partners with and what differentiates its service offering.
- How the organisation is resourced, including information about the management team and board, is important. Analysis and commentary on the funding and revenue mix – existing and proposed - are also seen as essential in understanding the financial foundations of a non profit organisation.
- The key uses of funding should be outlined and clear reporting of the funding direction is critical. A concise explanation of the mix of program and infrastructure funding is important, especially in clarifying the often significantly underestimated need by donors for non profits to have quality organisational infrastructure (including appropriately compensated management talent).

The format of the Annual Report would be adapted as needed for the needs of the varying categories of organisations with DGR status (eg. the above information would not all be relevant to say art-based organisations).

As an aside, we note that there have been suggestions by various bodies for an accounting standard to be developed uniquely for the non-profit sector. Whilst we acknowledge that this would assist in consistency of format, presentation and definition of various aspects of the reporting of the financial results of non-profit organisations, we believe the transparency/reporting required needs to go much further than just financial information. It is important to recognise that non-profit objectives are about much more than generating shareholder value and profits - so a reporting framework mirroring the corporate world is not the best starting point.

SVA is interested in working collaboratively with government and the sector to develop an online national database of information on charities with DGR status. Indeed, SVA has already undertaken advanced planning of a “one stop” web portal to house such information.

### **Release of timely national data**

The lack of accurate, regular, timely, relevant and high quality national data on the non-profit sector inhibits the sector’s ability to improve its operational capacity and to attract, maintain and increase private sector support.

SVA notes that the Australian government is the key source of national statistics and recommends that the government commit to the ABS producing and publishing high-quality annual statistical reports on the non-

profit sector (or its various components, such as charities with DGR status). The source of this data could include:

- Summarised information from the Annual Reports lodged by DGRs (as proposed above)
- Information lodged by taxpayers in their income tax returns
- Information lodged by Prescribed Private Funds with the ATO

### **Legal Structures**

We believe the legal and regulatory structures/regimes which govern the non profit sector (both State and Federal) are complex, inconsistent and antiquated. Although there are others much better qualified than us to make expert comment on this area, we would note the following high level observations:

- There appears multiple definitions in multiple jurisdiction of what constitutes a “charity”. There would be great efficiencies in having one central group that determines this.
- There appears to be a number of different legal structures to house a non profit organisation. In the case of those charities with DGR status, we think consistency of structure would be useful (perhaps a company limited by guarantee).
- If DGRs had a common legal structure (say a company limited by guarantee), the “standard” constitution should make it very clear the tenure and interaction between members and directors to ensure that there is a strong, contemporary and independent governance given there are not the normal “safeguards” that current shareholders provide to commercial organisations. For example, compulsory rotation of directors could be a useful safeguard.

### **Encouraging Social Investment**

There are additional mechanisms required to support the emerging social business/social enterprise sector. For example, in the USA (via LC3's) and UK (via CiC's), specific legal structures have recently been created which allow for hybrid investment models and tax incentives for social investors. We believe this needs to be considered and developed for the Australian market to encourage investment in the not for profit sector.

### **Miscellaneous taxation issues**

We believe that the definition and usefulness of “Public Benevolent Institution” (PBI) is outdated. It appears that charitable organisations seek to be classified as a PBI for the sole reason of accessing favourable Fringe Benefits Tax exemptions. We believe all organisations with DGR status should be given the most favourable FBT exemptions available. This is particularly the case given the large disparity between salaries in the non profit sector compared to the commercial sector, making it difficult to attract and retain good staff in the prime of their careers. If maximum FBT concessions were available to all DGRs this would assist in partially addressing this disparity.

Currently, there are complex tax issue relating to non-profit organisations undertaking income-generating activities. We believe the Government should legislate to remove the case law uncertainty around income producing activities of charities. Specifically, SVA recommends that Recommendation 18 of the Inquiry into the Definition of Charities and Related Organisations be implemented enabling all organisations with DGR status to undertake such activities where they further, or are in aid of, the dominant charitable purpose or where they are incidental or ancillary to the dominant charitable purpose. Given the ongoing difficulties of most non profit organisations in raising donations, we believe such organisations should not be impeded from carrying out income producing activities for fear of jeopardising either their DGR status or Tax Concession Charity (‘TCC’) status.

### **Capacity Funding**

In the experience of SVA, one of great problems of the non profit sector is building the capacity of the sector to sustain innovation and we undertake a range of programs to improve knowledge and practices within the sector, including through the sharing of best practice. Most donors to the sector want their funding to go to “projects” (ie the end beneficiary) rather than applied to building/strengthening the organisation itself. Because of this, the non profit sector continues to be a very disparate “cottage industry”.

SVA recommends that government consider supporting capacity building in the non-profit sector. There are examples of this occurring with very positive outcomes in the cultural sector through the Major Performing Arts Inquiry and the Visual Arts and Crafts strategy following the Myer Inquiry into Visual Arts and Crafts. Possible mechanisms for resourcing support for capacity building include:

- establishment of a FUND for this purpose for the sector (cf Future Fund and Environment Fund);
- provide support for organisations within the sector, such as SVA, that are working to build capacity.

We would be happy to expand on these views further as required or to work with the Government on implementing possible solutions.

**Senate Standing Committee on Economics**  
**Inquiry into Disclosure regimes for Charities and not-for-profit organisations**

**SVA's response – Part 2**

**Inquiry Terms of Reference**

1. Relevance and appropriateness of current disclosure regimes for charities and all other not-for-profit organisations
2. 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
3. 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

**Specific Questions asked in the Background Paper**

**Concerns about the NFP sector**

- i. **Are current disclosure regimes for not-for-profit organisations adequate?**
  - **If so, why (taking into account concerns such as those expressed by *Choice*)?**
  - **If not, why not?**

SVA's view is the current disclosure regimes are inadequate. The complexity of the differing reporting and compliance requirements and their implementation is a major burden for not-for-profits (NFPs). It results in significant wastage of both time and resources which impacts negatively on program delivery, staff morale, community trust and ability to attract private sector financial support.

- ii. **What would be the potential advantages and disadvantages for not-for-profit organisations of moving towards a national disclosure regime? How might any disadvantages be minimised?**

The principal advantage of moving to a national disclosure scheme would be national consistency of reporting. This would facilitate the production of reliable national data for the sector, enable bench-marking within the NFP sector and improve communication between the sector and the community (including donors). In addition, for NFPs that work across different states and territories, it would significantly reduce the quantum of reporting required and hence the level of resourcing applied to this area.

There could be some disadvantage for small NFPs in that their new reporting requirements could be more complex than their current requirements. However, we believe that all NFPs should be treated the same and basic and consistent disclosure should be the "price of entry" for participants (and in particular those who have been given DGR status).

- iii. **Would a standardised disclosure regime assist not-for-profit organisations that undertake fundraising activities, and that 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)?**

Yes, if the standardised disclosure regime included parameters for reporting on fundraising this would be beneficial for NFPs that operate nationally (see general response to question (ii) above).

- 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-profits?**

From a consistency perspective, it may be preferable for all NFPs to be treated the same. However, at minimum we believe all organisations with DGR status should be “carved out” and a nationally consistent disclosure regime applied to them. Because of the tax benefits to donors of giving to charities with DGR status, we believe there should be a higher level of transparency, consistency and probity on these organisations.

- 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, i.e., 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)?**

See above.

### **Calls for regulatory reform**

- 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 that use public and/or government funds?**
- **Who should be responsible for progressing and/or funding these measures?**
- **How might the uptake of these measures be monitored?**

SVA supports legislative reform of the NFP sector, and in particular for those organisations with DGR status.

**If so:**

- **What should be the objectives of reform?**

SVA sees the principal objective of reform as being improved transparency of reporting not only in relation to financials, but also governance, and program outcomes and impact. The establishment of a single definition of a charity (as recommended by the Inquiry into the Definition of Charities and Related Organisations – June 2001 and the National Roundtable of Non-Profit Organisations) would be a major step forward in simplification and consistency. In addition, simplification of the legislative frameworks governing the sector would facilitate improved transparency of reporting.

- **Are there minimum requirements that must be met in order for a national regulatory system to be worthwhile?**

Yes. The national regulatory system should require a high level of accountability in all areas of operation, including governance.

A reporting framework suggested by the UK Charities Commission (as cited by The Institute of Chartered Accountants Australia) is provided at Attachment 2. SVA supports the position of the UK Charities Commission and recognises the need for NFP’s reporting to include a well-structured Annual Report that covers:

- the NFP’s purpose;
- the programs the NFP is running and how they are performing;
- a summary of the environment in which the NFP is operating;
- how the NFP is resourced; and
- the NFP’s key issues of funding.

We also recognise the need for consistency in definition and format of financial numbers for an Annual Report. However, we believe the consistency and format of qualitative information is equally as important for a sector whose outputs are usually not money related.

- **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 above a specified threshold etc?**

At minimum we believe regulatory reform should apply to those organisations with DGR status. This would make it relatively to achieve compliance with matters such as annual reporting because the penalty for non compliance could be suspension of the DGR status.

- **Where should the impetus for reform come from? Who should drive reform?**

SVA supports the Commonwealth government undertaking this role.

- **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 that comprise the not-for-profit sector?**

Given the current intersecting roles of the Commonwealth, State and Territory governments in relation to the NFP sector, there would need to be inter-governmental consultation as well as sector consultation. The government could work with peak bodies within the NFP sector to facilitate consultation across the sector.

- **Are there 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 or disadvantages of these models?**

*The Report of the Inquiry into the Definition of Charities and Related Organisations – June 2001* recommended the establishment of an independent administrative body for charities and related entities, similar to those in place in UK and New Zealand. SVA would support the implementation of this recommendation. With a total focus on the NFP sector, the new body would develop an overview of sector issues and become a credible voice on sector needs to government and the community.

**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 regulator?**

SVA supports the establishment of a single national regulator for the NFP sector.

**If so:**

- **Should a national regulator be responsible for the entire not-for-profit sector or only the charitable sector?**

At minimum, we believe the regulator should be responsible for those charitable organisations with DGR status. However, we acknowledge that there may be advantages in having a whole-of-sector overview, particularly in relation to improving communication across the sector, production of sector-wide data and bench-marking.

- **Should the regulator be independent of government?**

SVA supports the regulator being independent of government, but accountable to government.

- **Where should 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.**

SVA supports the regulator being a stand-alone agency.

- **What would be the role of a national regulator? For example, should it have an:**
  - **educative / advisory role?**
  - **enforcement role?**
  - **mediation / dispute resolution role?**

SVA supports the role of the national regulator encompassing all three roles listed above. (cf UK Charities Commission)

- **Should a national regulator be responsible for making decisions about charitable status**

SVA supports the national regulator having responsibility for decisions regarding charitable status and all related issues, including maintenance of a register of those organisations with DGR status and the monitoring/management of these. SVA supports DGR self-regulation being a more rigorous process than currently is the case given that DGR status is a significant benefit for an organisation. SVA proposes that all DGR organisations be required to respond (on-line) to a set of questions on their operations by a specified date annually and that failure to meet this requirement would result in suspension of DGR status until the requirement is met. The national regulator would play a supporting role in addressing such situations.

- **Should a national regulator be funded? For example, by the federal government, by federal, state and territory governments, on a cost recovery basis?**

SVA supports the national regulator being funded by the Commonwealth. SVA does not support a cost recovery approach as it would impose an additional financial burden on the sector and impact negatively on program delivery.

### 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?**

SVA supports a reduction in legal structures for the NFP sector. However, if this would be unworkable because of the differences within the entire NFP sector, then at minimum we would support a single legal structure for those with DGR status. This would perhaps be a company limited by guarantee.

**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?**

We are not qualified to comment, though we suspect that the referral of powers from the states and territories to the Commonwealth would be the better way to address the issue.

- **What should be the minimum features of any legal structure?**

Limitation of directors liabilities, compulsory rotation of directors, mandated reporting requirements.

**References**

*Accounting and Reporting by Charities: Statement of Recommended Practice* United Kingdom Charity Commission 2005

*Choice Report – Charities*

*Enhancing not-for-profit annual and financial reporting* Institute of Chartered Accountants Australia 2007

National Roundtable of Nonprofit Organisations – Fact Sheet

*Not-for-profit sector reporting: a research project* Institute of Chartered Accountants Australia 2006

*Proposal for simplifying the legal form and regulation of small for-profit businesses and not-for-profit entities* Senator Andrew Murray April 2008

*Report of the Inquiry into the Definition of Charities and Related Organisations* – June 2001

**Extract from *Accounting and Reporting by Charities: Statement of Recommended Practice*  
United Kingdom Charity Commission 2005**

Charity accounts alone do not meet the information needs of users who will usually have to supplement the information they obtain from the accounts with information from other sources. Accounts also have inherent limitations in terms of their ability to reflect the full impact of transactions or activities undertaken and do not provide information on matters such as structures, governance and management arrangements adopted by a charity. The accounts of a charity cannot alone easily portray what the charity has done (its outputs) or achieved (its outcomes) or what difference it has made (its impact). This is mainly because many of these areas cannot be measured in monetary terms: indeed some areas are difficult to measure with any numbers at all. The...Annual Report provides the opportunity for charity (Boards) to explain the areas that the accounts do not explain.

Charity accounts should therefore be accompanied and complemented by information contained within the...Annual Report. The...Annual Report should be a coherent document that meets the requirements of law and regulation and provides a fair review of the charity's structure, aims, objectives, activities and performance. Good reporting will explain what the charity is trying to do and how it is going about it. It will assist the user of accounts in addressing the progress made by the charity against its objectives for the year and in understanding its plans for the future. Good reporting will also explain the charity's governance and management structure and enable the reader to understand how the numerical part of the accounts relates to the organisational structure and activities of the charity.