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The Treasury

Senate Standing Committee on Economics

**Inquiry into the disclosure regimes for charities
and not-for-profit organisations**

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INTRODUCTION

Not-for-profit (NFP) organisations make up a diverse sector of the Australian economy, providing charitable, religious, health, education and leisure services to the community and disadvantaged groups. Along with the sector's contribution to the Australian economy, NFP organisations also play a key role in the delivery of government services, particularly in relation to the Government's social inclusion policies.

NFP organisations have important internal relationships with their members, donors, employees and volunteers, and external relationships with their beneficiaries, trade creditors and the broader community, as well as governments. The integrity, efficiency and effectiveness of the NFP sector are important aspects for maintaining the trust and confidence of these stakeholders.

Through market regulation, governments can create an enabling environment to complement the fundamental market settings in which NFP organisations operate and intervene to address market failures. To achieve a well functioning market, the regulatory framework applying to these organisations should attempt to:

- ensure the integrity and certainty of the market in which NFP organisations operate; and
- provide for participants to bear an appropriate degree of risk, by providing appropriate consumer protections, ensuring accountability, transparency and member rights, and deterring misconduct.

In Australia, responsibility for the regulation of NFP organisations is currently shared between the Commonwealth and the states and territories for constitutional reasons. To assist the inquiry, this submission will examine the features of the market regulatory arrangements for incorporated NFP organisations in Australia, including:

- the features of the NFP sector;
- the conceptual rationale for the market regulatory framework;
- the current arrangements in relation to governance and financial reporting regulation, as well as recent Commonwealth Government regulatory reform proposals;
- the current arrangements in relation to charitable fundraising regulation, including summaries of the South Australian and Victorian regimes;
- recent Commonwealth Government non-regulatory initiatives to foster an engaged and active NFP sector through a National Compact; and
- brief summaries of the regulatory arrangements in the United Kingdom and New Zealand.

The submission is supported by attachments containing tables of numerical data on the sector as well as a summary of key state and territory regulatory requirements.

FEATURES OF THE NOT-FOR-PROFIT SECTOR

At the end of June 2007, there were 40,976 NFP organisations in Australia registered for an Australian business number (ABN).¹ There are additional NFP organisations that do not fall within the ABN registration requirements, that is, they would have an annual turnover of less than \$150,000 and have decided not to register voluntarily. There are an estimated 147,000 NFP organisations using a registered incorporated structure.²

During the 2006-07 financial year, ABN registered NFP organisations:

- employed 884,476 people;
- received \$74.5 billion in income, two components of which included:
 - 34.1 per cent (\$25.4 billion) from commonwealth, state and local governments; and
 - 9.4 per cent (\$7 billion) from donations, sponsorship and fundraising; and
- incurred \$68.3 billion in expenses.

In addition to paid employees, there were 2,434,815 volunteers during 2006-07.³

While NFP organisations are varied in their aims and activities, they are all constituted to preclude profits or surplus assets on cessation being returned to members. Profits must be put to the organisation's objectives, and, on winding up, surplus assets are generally distributed to another NFP organisation with similar objectives.

There is no requirement in Australian law for NFP organisations to take a particular structure. Structures available for NFP organisations in Australia include public companies limited by guarantee, incorporated associations, co-operatives, entities incorporated under their own statutes, trusts, partnerships and unincorporated associations. Each structure will have its own governance and reporting obligations under contract and the applicable statutory and common law. This submission focuses on incorporated structures.

Incorporated not-for-profit organisations

Incorporated structures are generally stable and identifiable vehicles that allow groups of individuals to combine accumulated resources and spread the risks of the venture across all of those involved. While incorporation is granted upon an organisation registering with a regulator, an organisation's NFP or charitable status is usually provided for by the organisation's constituent document or by operation of law. Registration as an NFP or charity may be necessary for an organisation's access to tax concession or ability to raise funds from the public.

Incorporated structures provide the organisation with separate legal identity and perpetual succession, which allow it to own property, make contracts, and sue and be sued in its own name. In addition, these structures have access to limited liability. That is, the members' liability is limited to what they agreed to contribute to the entity. An

¹ ABS, 8106.0, Not-for-profit Organisations, Australia, 2006-07. See Attachment A for further information.

² See Attachment B.

³ ABS op cit.

incorporated entity's creditors have recourse only to the entity's assets (with limited exceptions) rather than the totality of the members' personal assets.

AIMS OF A REGULATORY FRAMEWORK FOR NOT-FOR-PROFIT ORGANISATIONS

For market integrity reasons, regulation should facilitate the establishment and governance and reporting of NFP organisations, as well how they engage externally in the market, such as raising funds from the general public.

In addition, specific administrative regulatory requirements beyond these market regulatory requirements or contractual obligations may be warranted where NFP organisations receive public monies from governments to deliver services. These issues are not canvassed in this submission.

Governance regulation

Governance concerns arise when a group of individuals form an association by combining resources in pursuit of common objectives and, in the interests of efficient operation, delegate control of these assets to a specialist group of managers. Where there is a separation of the ownership of the NFP entity and the control of its assets, risks stemming from informational asymmetries⁴ and agencies costs associated with monitoring arise.

It is assumed that managers will better promote the interests of members if there are sanctions for shirking or misconduct and rewards for performance. Members can address these issues (by retaining certain decision making rights and requiring certain disclosures) privately through contractual means often enshrined in an organisation's constituent document. This requires monitoring by members, which increases the cost of capital and may lower the incidence of forming these organisations in the market to below an optimal level.⁵ An individual member's willingness to monitor the management may also be affected by free rider concerns that benefits would flow to other members who have not borne a fair share of the cost.⁶ In addition, given the largely voluntary nature of the NFP sector, market settings associated with financially rewarding performance may be impeded.⁷

As such, monitoring by regulators, such as enforcement of governance and reporting obligations, can also lower these costs and work to promote integrity in the market.

Current arrangements

Companies limited by guarantee

The Commonwealth, by virtue of the corporations head of power in the Constitution (paragraph 51(xx)) and the referral of power from the States under the *Corporations*

⁴ Such as imbalances between what owners and managers know about the operations and prospects of the organisation.

⁵ F H Easterbrook and D R Fischel, *The Economic Structure of Corporate Law*, Harvard University Press, Cambridge, 1991, pages 76-77.

⁶ A Mas-Colell, M D Whinston and J Green, *Microeconomic Theory*, Oxford University Press, New York, 1995, page 362. M L Katz and H S Rosen, *Microeconomics*, Irwin, Illinois, 1991, pp 240 1.

⁷ E F Fama and M C Jensen, 'Separation of Ownership and Control', *Journal of Economics and Law*, vol. XXVI, June 1983, 301 at 312. R A Posner, *Economic Analysis of Law: Fifth Edition*, Aspen Law & Business, New York, 1998, p451.

Agreement 2002 (Corporations Agreement), has the authority to regulate for the 11,000 NFP organisations that are constituted as companies limited by guarantee.

Companies limited by guarantee are public companies without share capital whose members' liability is limited to an amount members agree to contribute on winding up, if there is a deficit.⁸ These companies are generally larger or national organisations, must register with the corporate regulator, the Australian Securities and Investments Commission (ASIC), and comply with the same governance requirements in the *Corporations Act 2001* (Corporations Act) as for-profit public companies. Examples of NFP organisations using the company limited by guarantee structure include Autism Spectrum Australia (Aspect), *Médecins Sans Frontières* Australia and The Wombat Foundation.

Companies limited by guarantee can have a constitution or operate under the replaceable rules or a combination of both.⁹ There is no requirement in the Corporations Act for a company limited by guarantee to conduct itself as an NFP entity; the preclusion from distributing profits or surplus assets to members is generally found as a clause in the company limited by guarantee's constitution. The presence of this clause in a company's constitution is also necessary for the company to omit 'Limited' from its name.¹⁰

Companies limited by guarantee must have a minimum of one member, and, as public companies, they must have a minimum of three directors and must appoint a company secretary.¹¹ Specific governance requirements and disclosure obligations also include the statutory directors' duties and rules facilitating member participation, such as the rules for company meetings and voting.¹² Companies limited by guarantee can be excluded from the operation of the related party transaction provisions where their constitution prohibits payment of fees to directors and requires director approval of all other payments to directors.¹³ These requirements can generally be enforced by members as well as ASIC.

Incorporated associations and co-operatives

The remainder of incorporated NFPs are constituted as incorporated associations or, to a lesser extent, co-operatives. The corporate regulatory arrangements for these organisations are generally the responsibility of the states and territories. Recent reports from state and territory agencies indicate that there are approximately 134,858 incorporated associations and 1,837 co-operatives registered in Australia.¹⁴ The Corporations Agreement specifically excludes the Commonwealth from legislating for the regulation of state and territory incorporated entities, except to the extent that these organisations operate outside of their home jurisdiction.¹⁵

As legislation differs in each state or territory, it is difficult to outline detailed requirements for incorporated associations.¹⁶ In general incorporated associations are required to have a minimum of five members and be formed for an eligible purpose, such as a religious, charitable, educational, political, sporting or artistic purpose. They are also generally precluded from predominantly carrying on trading activities. Examples of NFP organisations using the incorporated association structure include RecLink Australia

⁸ See section 517 of the *Corporations Act 2001* (Corporations Act).

⁹ Section 134 of the Corporations Act.

¹⁰ See sections 150 and 151 of the Corporations Act.

¹¹ Section 114 and subsections 201A(2) and 204(2) of the Corporations Act.

¹² See for example Chapters 2D and 2G of the Corporations Act.

¹³ See sections 9, 150 and 151 of the Corporations Act.

¹⁴ See Attachment B. Not all co-operatives will be NFP organisations. Some co-operatives, such as trading co-operatives, may be constituted as for-profit organisations.

¹⁵ Clause 503 of the *Corporations Agreement 2002* (Corporations Agreement).

¹⁶ See Attachment C for a summary of key governance requirements for incorporated associations across jurisdictions.

Incorporated (registered in Victoria) whose programs include the Choir of Hard Knocks, and Trees for Life Inc (registered in South Australia), as well as the state and territory Surf Live Saving Associations.

Incorporated associations must register with the relevant state or territory regulator, such as a consumer affairs commission or office of fair trading, and comply with the governance obligations in these state and territory laws. The requirements are generally considered less onerous and more suitable to smaller community sector organisations. Similar to members of companies limited by guarantee, an incorporated association members' liability is limited to an amount they agree to contribute during membership, usually as subscription payments, or on winding up.

Generally, incorporated associations are managed by a management committee. Members of the management committee are required to exercise their powers to further the aims of the association. As an example, the New South Wales model rules provide that a management committee should consist of a minimum of seven members, including a president, vice-president, treasurer, secretary and three ordinary members.¹⁷

The committee operates similarly to the board of directors for a company. Committee members are subject to similar general law and, in certain jurisdictions, similar statutory obligations to company directors in areas such as directors' duties, conflict of interest and disclosure rules.

Except in Western Australia, all incorporated associations must appoint a person to be a 'public officer' (or 'secretary' in Queensland). They operate in a similar manner to a company secretary and are generally responsible for the association complying with its regulatory requirements.

Incorporated associations must hold annual general meetings once every calendar year. Generally associations must keep minutes of all committee and general meetings and maintain registers of members and committee members.

A co-operative is an entity voluntarily owned and controlled by the people for whom it was established and who use its services. It may be formed for the provision of goods or services to its members or for the supply of goods or services to the general public. An example is the University Co-operative Bookshop Limited (The Co-op Bookshop).

Generally there are two types of co-operatives, a trading co-operative and a non-trading co-operative. The legal requirements differ depending on the type of co-operative. Generally, a trading co-operative may or may not have share capital, and have rules that authorise it to give returns or distribution of profit or surplus assets. A non-trading co-operative may or may not have share capital and have rules that prohibit from giving returns or distribution of profit or surplus assets.

Different jurisdictions have adopted different approaches to the extent to which reliance is placed on state authorities to monitor compliance with governance requirements. Similarly, as the states and territories are responsible for these laws, any reform proposals or priorities would be a matter for the states and territories.

Incorporated associations and co-operatives are also required to register with ASIC as 'registrable Australian bodies' if they wish to operate outside of their home jurisdiction. In general, ASIC has regulatory oversight of registered Australian bodies' governance and

¹⁷ NSW Office of Fair Trading, *Model rules for incorporated associations*, Parramatta, December 2007, page 10.

reporting activities to the extent they occur outside of their home jurisdiction, and in relation to compliance with notification of changes to the bodies' features.¹⁸

Recent Commonwealth Government reform proposals

The Minister for Superannuation and Corporate Law, Senator the Hon Nick Sherry, has recently announced that the Treasury will examine enhancements to corporate governance framework in three key areas: corporate offences, sanctions and personal liability for directors.¹⁹ The object of this project is to examine whether the current obligations placed on directors provide clear standards of behaviour and ensure that failure to meet those standards is met with credible, flexible, and transparent sanctions. Relevant obligations would include the Corporations Act duties of care, diligence, good faith and insolvent trading. The underlying theme is to examine whether there is a consistent and principled approach to addressing misconduct in corporate law. The directors' obligations that are the subject of this work generally apply equally to the directors of NFP and for-profit companies.

In addition, the Treasury is participating in a joint research project with the National Institute of Governance at the University of Canberra examining best practice corporate governance arrangements and regulation for small corporations. The research phase of project will commence in shortly and has a three-year time line. The project will seek to identify the needs of small corporations, and how these might best be addressed through regulatory and non-regulatory means. Governance issues considered as part of this project are likely to be relevant for small NFP and for-profit companies alike.

Financial reporting regulation

Financial reporting is a key aspect of the governance regulation of NFP entities. By providing members with information regarding the financial position and performance of the entity, financial reporting assists in reducing the information asymmetries between members and the management of the entity.²⁰ This allows members to more effectively monitor the activities of management.

Financial reporting regulation can also introduce an additional level of external monitoring of management through the introduction of auditing requirements. These require management to engage an external auditor to provide assurance to members regarding the accuracy of the financial information provided to members by management.²¹ This encourages management to ensure it has strong internal controls governing the financial activities of the entity.

As with the other aspects of the governance framework, it would be possible for members to contract privately with management to require the provision of financial information in the absence of statutory requirements. However, consistent requirements through legislation can be more efficient and cost effective approach to ensure that comparable information is prepared by NFP entities.²² In addition, the demand for financial information in relation to NFP entities extends beyond members to a broader range of

¹⁸ See for example section 190A and Part 5B.2 of the Corporations Act.

¹⁹ Minister for Superannuation and Corporate Law, *Keynote Address*, speech to ASIC Summer School, Melbourne, 19 February 2008. Delivered on the Minister's behalf by Dr Ken Henry AC, Secretary to the Treasury. See also, Minister for Superannuation and Corporate Law, *Corporate governance in today's volatile market condition*, speech to Riskmetrics Group Australia Governance Conference, Melbourne, 28 April 2008.

²⁰ Easterbrook and Fischel, op cit, pages 302, 311.

²¹ J Farrar, *Corporate Governance in Australia and New Zealand*, Oxford University Press, Melbourne, 2001, page 211.

²² Easterbrook and Fischel, op cit, page 303.

stakeholders (for example, creditors and people receiving services from the NFP entity). Imposing financial reporting requirements through legislation ensures that all user needs are addressed rather than just the needs of members.

Current arrangements

The Commonwealth has responsibility for setting financial reporting requirements for entities registered under the Corporations Act, and for the development of national accounting standards.

NFP organisations that are registered as public companies limited by guarantee must prepare an annual financial report and a directors' report in accordance with Australian accounting standards.²³ The financial report must be audited in accordance with Australian auditing standards by a registered company auditor.²⁴

In relation to the financial reporting requirements for incorporated associations, while the Commonwealth has responsibility for the development of national accounting standards, the State and Territory laws would dictate whether or not these organisations would have to report in accordance with them.

The financial reporting requirements of incorporate associations vary among jurisdictions.²⁵ Most jurisdictions require incorporated associations to prepare accounts that give a true and fair view of the entity's income and expenditure, assets and liabilities, any mortgages and charges and the activities of any trusts controlled by the entity. Generally, there is no express requirement for this information to be prepared in accordance with Australian accounting standards (except for Victoria) though in some jurisdictions the entity's auditor is expressly required to comment on whether the accounts are true and fair if accounting standards have not be complied with. Most jurisdictions have adopted differential auditing requirements whereby small incorporated associations are either not required to have their accounts audited or are allowed to have their accounts audited by a wide range of individuals (not all of whom are registered company auditors).

Australia does not have a stand-alone NFP accounting standard. Consistent with Australia's policy of international harmonisation of accounting standards (that is, consistent accounting requirements across the globe), Australia has adopted International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) for use by Australian entities. Over 100 countries now either permit or mandate the use of IFRS in their jurisdiction. IFRS are developed for for-profit entities. In order to make them suitable for use by NFP entities, the Australian Accounting Standards Board (AASB) currently reviews each IFRS standard before it is issued in Australia and makes any amendments considered necessary to make them suitable for application by NFP entities. This ensures that the standards appropriately take into account the differing nature of all entities that will be required to apply them, including government bodies, corporations and NFPs.

Governments may also place financial reporting requirements on NFP organisations where they receive funding or grants for the delivery of government services for acquittal purposes. As mentioned above, these administrative regulatory requirements are not canvassed in this submission.

²³ See Part 2M.3 of the Corporations Act.

²⁴ Section 301 of the Corporations Act.

²⁵ See Attachment C for summary of key financial reporting requirements for incorporated associations across jurisdictions.

Recent Commonwealth Government reform proposals

The Treasury is currently reviewing the financial reporting requirements for companies limited by guarantee under the Corporations Act. As noted above, this is a structure used by approximately 11,000 NFP entities. As part of this review, the Treasury issued a discussion paper on the financial reporting requirements for companies limited by guarantee in June 2007.²⁶ This paper elicited submissions from a broad range of stakeholders including auditors, NFP entities, professional bodies and stakeholder organisations. The Treasury is currently reviewing the submissions to this paper and expects to brief Ministers on potential reform options in the coming months.

Fundraising regulation

A key activity for NFPs is seeking donations of funds and other resources from the public that can then be used or redistributed in furtherance of the NFPs' objects.

However, the intangible nature of these transactions raises similar risks associated with informational asymmetries that NFP organisations will misappropriate these funds or secure them by fraud. This would impose a higher cost on the decision to donate, which would also lower the incidence of donation in the market below an optimal level. Whereas members can exercise their membership rights to oversight the organisation's use of member funds, as donations are sought from the public generally there would not be a sufficient connection for effective private monitoring and oversight of the fundraising activity.

Specific regulation of fundraising can provide consumer protections to lower these risks, improving the integrity of the fundraising activities and encouraging more donations.²⁷

Disclosure can play a role in fundraising regulation in relation to ensuring people or organisations:

- identify themselves in the course of fundraising; and
- represent the purpose of their organisation or their fundraising activities.

The challenge is to ensure that fundraising regulation complements inherent market settings and achieves an appropriate balance between providing sufficient disclosure and transparency to potential donors without unduly burdening fundraisers and stifling fundraising capacity.²⁸

Current requirements

The states and the Australian Capital Territory (ACT) regulate NFP fundraising and gaming activities, such as raffles and bingo. The Commonwealth does not regulate these activities.

As with associations incorporation legislation, the legislation regulating the reporting and conduct of fundraising differs between states and the ACT.²⁹ All NFPs seeking permission to fundraise nationally are generally required to seek licences, or register, from the various Ministers, or regulators, in each state and the ACT, regardless of the corporate structure

²⁶ Treasury, *Financial reporting by unlisted public companies: Discussion paper*, Canberra, June 2007.

²⁷ Victorian State Services Authority, *Review of not-for-profit regulation: Final report*, Melbourne, September 2007, page 43.

²⁸ *ibid.*

²⁹ See Attachment C for summary of charitable fundraising laws across jurisdictions.

they use. There does not appear to be mutual recognition of cross-border licences or registrations. Two examples, the South Australian *Collections for Charitable Purposes Act 1939* and the Victorian *Fundraising Appeals Act 1998*, are discussed below.

Collections for Charitable Purposes Act 1939 (SA)

The South Australian *Collections for Charitable Purposes Act 1939* (the South Australian Act) prohibits persons from collecting or obtaining, or attempting to collect or obtain, monies or goods for charitable purposes unless the person holds a licence. The South Australian Act also provides that persons must not conduct entertainment, for which the proceeds from admission are to go to charitable purposes, unless the person holds a licence.

Under the South Australian Act, applications for a licence are to be made to the Minister and the decision whether to grant a licence is at the Minister's discretion. The Minister can impose conditions on the licence. The South Australian Act provides that licence holders are to keep proper accounts, furnish accounts to the Minister as requested and appoint an auditor. The Minister may make recommendations to the Governor of South Australia that collected funds be distributed to another body if necessary. Further, the Governor can vest monies on the Minister to be held in trust if requested by three quarters of the persons in control of the money, or maladministration of the money has occurred.

Fundraising Appeals Act 1998 (Vic)

Another example is the Victorian *Fundraising Appeals Act 1998* (the Victorian Act), which provides that a person must not conduct a fundraising appeal unless they are registered. Registration is granted by the Director of Consumer Affairs Victoria, and the time of the grant must not exceed five years. Schools, religious organisations, health organisations, political parties, trade unions and workplace organisations are exempt from these requirements.

The Victorian Act provides requirements for book keeping and auditing, as well as providing a right for the public to access information on request, including the right to inspect the register maintained by the Director.

The Victorian Act also requires that during fundraising activities, fundraisers must wear an identifying badge at all times and phone canvassers and documentary solicitations must give out certain information.

RECENT COMMONWEALTH GOVERNMENT NON-REGULATORY INITIATIVES FOR THE NFP SECTOR

National Compact

The Australian Government, as part of its social inclusion agenda, is exploring ways to develop a stronger relationship with the NFP sector, based on partnership and respect. One way to do this is through a National Compact—an agreement between the Government and the NFP sector that outlines how the two will work together to improve and strengthen their relationship, now and into the future.

The social inclusion agenda recognises the critical role the NFP sector plays in delivering services, advising and developing social policy and advocating on behalf of marginalised groups. A strong relationship between the Government and the sector will be crucial to the success of the agenda and related reforms.

While recognising the independence of the NFP sector, a National Compact would provide a means to capture views of disadvantaged and marginalised groups and strengthen capacity within the sector to deliver efficient, effective and innovative services in response to community needs.

A National Compact could include:

- a high level of statement of purpose and agreed values;
- a statement of roles and responsibilities;
- an evaluation and accountability framework;
- identification of industry issues;
- frameworks for dialogue and policy development;
- an implementation plan covering governance, communication and dispute resolution; and
- consideration of the contribution and needs of volunteers.

The Department of Families, Housing, Community Services and Indigenous Affairs is consulting widely to seek the initial views of community organisations and users of community services. This includes commissioning the Australian Council of Social Service (ACOSS) to canvass and report on the sector's views on the value of the National Compact.

In addition, the Parliamentary Secretary for Social Inclusion and the Voluntary Sector, Senator the Hon Ursula Stephens, has written to a range of peak bodies, state and territory governments and NFP organisations seeking their comments on a National Compact and established an expert panel to advise the consultation process.

Further information is available from the Department of Families, Housing, Community Services and Indigenous Affairs.

INTERNATIONAL COMPARISONS

United Kingdom³⁰

NFP organisations in the United Kingdom generally take incorporated or unincorporated forms and are regulated by the laws relevant to their operating structure and whether or not they are charities. Recently, the United Kingdom Parliament has legislated to create specific incorporated structures for NFP organisations in addition to the general company structure. These structures are Community Interest Companies and Charitable Incorporated Organisations.

³⁰ This section will focus on the arrangements in the jurisdictions of England and Wales. Scotland and Northern Ireland have generally instituted similar arrangements.

Community Interest Companies

Broadly, Community Interest Companies (CICs) can be thought of as hybrids between for-profit and NFP organisations. They are intended for use by companies carried on for a community interest that also wish to distribute profits to members in certain circumstances (also known as social enterprises). The CIC structure came into force on 1 July 2005 and can apply to private companies limited by guarantee, or by shares, or public limited companies. CICs must comply with company law generally, as well as complying with the specific CIC requirements.

A company will satisfy the community interest test, and therefore can utilise the CIC structure, if a reasonable person might consider that its activities are being carried on for the benefit of the community.³¹ A company will not be eligible if any of its activities benefit only the members of the company, without bringing any benefits (directly or indirectly) to a wider community.

CICs with share capital, and whose constitutions allow, may pay dividends to members subject to a dividend cap.³² Dividends are capped in two ways: a maximum dividend cap, where the amount of dividend attaching to a particular share is limited by how much the share is paid up, and an aggregate dividend cap, where only a percentage of available profit can be distributed as dividends. These levels are set in Regulations.³³ Otherwise, CICs are not able to distribute profits or assets to members, and any surplus on winding up must be distributed to another NFP organisation with similar objectives.

CICs are regulated by the Regulator of Community Interest Companies whose primary role is to encourage the development of CICs and to provide guidance and assistance on matters relating to them.

Charitable Incorporated Organisations

The Charities Act 2006 (UK) introduced a new incorporated structure specifically for charities, the Charitable Incorporated Organisation (CIO). CIOs are bodies corporate established for a charitable purpose, which must have constitutions and at least one member, who can have no or limited liability.³⁴ CIOs must use and apply their property in furtherance of their charitable purposes and in accordance with their constitutions, and each member and charity trustee (similar to a director) of the CIOs must exercise powers and perform functions in the way they decide, in good faith, would be most likely to further the purposes of the CIO.

Whereas charities using general company structures must register with both Companies House³⁵ and the Charity Commission of England and Wales, and comply with both company and charity law, CIOs are regulated solely by the Charity Commission. This extends to requirements for annual reports and annual returns.

³¹ Section 35 of the Companies (Audit, Investigations and Community Enterprise) Act 2004 (UK).

³² Section 30 of the Companies (Audit, Investigations and Community Enterprise) Act 2004 (UK).

³³ Currently set by the Community Interest Companies Regulations 2005. Maximum Dividend Cap: that percentage of the paid up value which is five percentage points higher than the Bank of England's base lending rate; and Aggregate Dividend Cap: 35 per cent of distributable profits.

³⁴ See generally Schedule 7 of the Charities Act 2006 (UK).

³⁵ Companies House supports the statutory office position of Registrar of Companies for England and Wales.

Regulation of charities

The Charity Commission of England and Wales (the Charity Commission) is established under the Charities Act 1993 (UK) and is the main regulator of charities in England and Wales. The Charity Commission's functions are to:

- promote the effective use of charitable resources;
- encourage the development of better methods of charity administration;
- give charitable trustees information or advice on any matter affecting the charity; and
- investigate and check abuses.³⁶

The Charity Commission also issues licences for public charitable collections.

Charities must register with the Charity Commission if they have an annual income of over £5,000 or are a CIO. At the end of March 2008, there were 190,387 charities registered with the Charity Commission, and they earned an annual income of £45.910 billion.³⁷

In relation to financial reporting, all charities must prepare accounts and make them available to the public on request. The duty to file accounts and a trustees' annual report (similar to a directors' report) with the Charity Commission applies to all registered charities whose gross income exceeds £10,000. Charities whose gross income falls below £10,000 are generally required to provide an annual update, as opposed to an annual return.³⁸

Under the charities law a charitable company with an annual income of more than £500,000 or assets of more than £2.8 million must prepare full annual reports on an accruals basis and have the reports audited. A charitable company with an annual income of between £100,000 and £500,000 and assets of £2.8 million or less must prepare simplified annual reports on an accruals basis and have the reports independently examined.³⁹ A charitable company with an annual income of between £100,000 and £10,000 or less must prepare simplified annual reports on either a cash or accruals basis and have the reports independently examined.⁴⁰ Charitable companies, apart from CIOs, must also generally comply with financial reporting requirements under companies law and file annual returns, prepared on an accruals basis, with Companies House.

New Zealand

NFP organisations in New Zealand also face a dual regulatory structure depending on which structure they use, and whether or not they are charities. NFP organisations in New Zealand generally take the form of companies, incorporated societies or trusts and are regulated by the Companies Act 1993 (NZ), Incorporated Societies Act 1908 (NZ) and Charitable Trusts Act 1957 (NZ) respectively. These organisations must register with the New Zealand Companies Office⁴¹, which keeps registers of the various types of

³⁶ Subsection 1(3) of the Charities Act 1993 (UK).

³⁷ Charity Commission, Facts & figures website, <http://www.charity-commission.gov.uk/registeredcharities/factfigures.asp>. Accessed 29 August 2008.

³⁸ Charities Commission, *CC15a - Charity Reporting and Accounting: The essentials website*, April 2008. <http://www.charity-commission.gov.uk/publications/cc15a.asp>. Accessed 29 August 2008.

³⁹ The independent examiner can generally be an auditor or an accountant.

⁴⁰ Charities Commission, op cit.

⁴¹ The New Zealand Companies Office supports the statutory office positions of Registrar of Companies and Registrar of Incorporated Societies.

organisations and makes them available for public search. These organisations must also comply with the applicable governance and financial reporting requirements relevant to their specific structure.

Where New Zealand NFP organisations are charities, regulatory obligations are also contained in the Charities Act 2005 (NZ) (the NZ Charities Act), which was passed in April 2005. The NZ Charities Act establishes the Charities Commission (the NZ Commission) which came into being on 1 July 2005.

The NZ Commission's functions are to:

- establish and maintain a registration and monitoring system for charitable organisations;
- provide support and education to the charitable sector on good governance and management;
- monitor annual returns submitted by registered charities;
- report and make recommendations to New Zealand Government about charitable sector matters;
- promote public trust and confidence in the charitable sector;
- encourage the effective use of charitable resources;
- educate charities about matters of good governance and management; and
- stimulate and promote research about the charitable sector.⁴²

Registration under the NZ Charities Act began on 1 February 2007 when the Charities Register opened and there are currently 11,000 charities registered. Registration is required for charitable organisations to be eligible for exemptions from income tax and gift duty, though New Zealand's Inland Revenue remains ultimately responsible for tax administration.

Once registered, charitable organisations must:

- file an annual return, including a copy of the charity's financial accounts and statement of the financial performance, within six months of their balance date; and
- notify the NZ Commission within three months if certain information about their organisation changes.

The NZ Charities Act also contains obligations around charitable fundraising.

If a registered charity does not comply with the NZ Charities Act, the NZ Commission has the authority to:

- impose administrative penalties;
- issue warning notices;
- publicise non-compliance;

⁴² Section 10 of the Charities Act 2005 (NZ).

- undertake further investigations; and
- deregister charities that have seriously or repeatedly failed to comply with the NZ Charities Act.

The NZ Commission also has the authority to check that registered charities are fulfilling their described purpose and complying with the NZ Charities Act.

Registered charitable organisations are exempted in certain circumstances from requirements in the laws regulating their operating structure where there may be duplication. For instance, charitable incorporated societies do not have to file annual financial statements with the New Zealand Companies Office once they have registered with the NZ Commission.⁴³

CONCLUSION

With diverse aims and objectives, NFP organisations provide important and necessary services to the Australian community and disadvantaged groups, particularly in circumstances where a lack of profit incentive may inhibit participation of for-profit organisations.

In Australia, NFP organisations can make use of many operational structures to pursue their objectives. This submission has focused on incorporated NFP structures, where responsibility for their market regulatory arrangements is generally shared between the Commonwealth and the states and territories for constitutional reasons.

Market regulatory arrangements applying to NFP organisations generally attempt to:

- ensure the integrity and certainty of the market in which NFP organisations operate; and
- provide for participants to bear an appropriate degree of risk, by providing appropriate consumer protections, ensuring accountability, transparency and member rights, and deterring misconduct.

In this regard, the current market regulatory arrangements include governance and disclosure requirements, in relation to financial reporting and public fundraising, to promote public confidence and participation both in and with NFP organisations.

Future reforms to these regulatory arrangements should reflect the evolution of the market in which these organisations operate, and seek to maintain a balance between the need to promote public confidence and participation against the need to manage the associated costs to the NFP organisations.

Non-regulatory initiatives can also play a role foster an engaged and active NFP sector. The Government is currently consulting on a National Compact—an agreement between the Government and the NFP sector that outlines how the two will work together to improve and strengthen their relationship.

Finally, an examination of international developments in the United Kingdom and New Zealand reveals that comparable common law jurisdictions have enacted specific regulatory requirements for charities, which also involve creating specific regulators

⁴³ Paragraph 23(4)(b) of the Incorporated Societies Act 1908 (NZ).

tasked with their oversight. In addition, the United Kingdom has created two new incorporated structures for use by social enterprises, which may wish to distribute profits in certain circumstances, and charities in an attempt to address any duplicated regulatory requirements for charitable companies.

ATTACHMENT A

ABN registered not-for-profit organisations in Australia¹

NFP Category	No. of organisations	No. of paid employees	No. of Volunteers	Industry value added \$	Income received \$	Industry expenses \$	Main source of income
Culture and Recreation	8,214	87,496	812,209	3.5b	11.9b	11.1b	Services (43.1% or \$5.1b)
Education and Research	5,661	216,211	204,610	10.4b	16b	14.6b	Federal, state and local govt (51.3% or \$8.2b)
Hospitals	106	55,803	6,774	3.1b	5.4b	5.2b	Services (67.1% or \$3.6b)
Health	724	93,627	62,211	3.1b	5.1b	4.6b	Federal, state and local govt (65.2% or \$3.3b)
Social Services	5,804	240,667	261,054	6.9b	12.2b	10.9b	Federal, state and local govt (55.1% or \$6.7b)
Environment, Development, Housing, Employment, Law, Philanthropic, International	7,197	104,889	319,775	3.6b	9.6b	8.9b	Federal, state and local govt (35.2% or \$3.4b)
Religion	8,743	41,369	484,980	1.3b	3.7b	3.2b	Donations, sponsorships and fundraising (38.2% or \$1.4b)
Business and Professional Associations, Unions	2,172	24,856	63,811	1.6b	4.3b	3.8b	Membership fees (46.9% or \$2b)
Other Activities	2,355	19,557	219,391	1.4b	6.3b	6b	Sales of goods (61.1% or \$3.9b)
Total	40,976	884,476	2,434,815	35.1b	74.5b	68.3b	Federal, state and local govt

¹ Australian Bureau of Statistics, 8106.0 – Not-for-profit Organisations, Australia, 2006-07.

ATTACHMENT B

Number of incorporated associations and co-operatives registered in Australia

Based on recent reports from state and territory agencies, this table contains the total numbers of incorporated associations and co-operatives registered with state and territory regulators. All incorporated associations must be NFP organisations according to relevant state and territory law. However, some co-operatives, such as trading co-operatives may be for-profit organisations.

	Associations	Co-operatives
Queensland	20,000 ¹	200 ²
New South Wales ³	39,801	728
Victoria ⁴	33,434	742
South Australia ⁵	18,368	56
Western Australia ⁶	15,330	68
Tasmania ⁷	3,683	39
Northern Territory ⁸	1,663	4
Australian Capital Territory	2,579 ⁹	.. ¹⁰
Total	134,858	1,837

¹ Queensland Office of Fair Trading, *Fair trading facts: Changes to association laws*, November 2007. Estimated numbers.

² Queensland Office of Fair Trading, *Cooperatives website* (<http://www.fairtrading.qld.gov.au/OFT/OFTWeb.nsf/web+pages/CC9AC3B6B448A9E04A256B570011F859?OpenDocument>). Accessed 25 August 2008. Estimated numbers.

³ Advice from New South Wales Attorney General's Department. Numbers as at 30 June 2008.

⁴ Consumer Affairs Victoria Annual Report 2006-2007, page 112-113. Numbers as at 30 June 2007.

⁵ South Australia Office of Consumer and Business Affairs Annual Report 2006-2007, page 44. Numbers as at 30 June 2007.

⁶ Advice from Western Australia Department of Consumer and Employment Protection. Numbers as at 16 September 2008.

⁷ Tasmania Department of Justice Annual Report 2006-2007, pages 59-60. Numbers as at 30 June 2007.

⁸ Northern Territory Commissioner of Consumer Affairs Annual Report 2006-2007, page 18. Numbers as at 30 June 2007

⁹ Australian Capital Territory (ACT) Department of Justice & Community Safety Annual Report 2006-07, page 73. Additions and deletions taken from 2003-04 base year of 2,418 associations, as published in ACT Department of Justice & Community Safety Annual Report 2003-04. Estimated numbers as at 30 June 2007.

¹⁰ Information not found.

Number of companies limited by guarantee

There are approximately 11,000 companies limited by guarantee registered under the *Corporations Act 2001*. This figure has been growing at 6 per cent per annum in recent years. As indicated in the following table, the size of these organisations is predominately small with close to 70 per cent having operating revenue of less than \$1,000,000.¹¹

	Revenue (%)	Cumulative Total: Revenue (%)	Assets (%)	Cumulative Total: Assets (%)
Less than \$200,000	41	41	35	35
Between \$200,001 and \$500,000	13	54	10	45
Between \$500,001 and \$1,000,000	14	68	18	63
Between \$1,000,000 and \$12,500,000	28	96	30	93
Between \$12,500,001 and \$25,000,000	2	98	2	95
Greater than \$25,000,000	2	100	5	100

These results are consistent with the findings of a survey of companies limited by guarantee in 2002 by The University of Melbourne¹² which found that 64 per cent had revenue of less than \$1,000,000. They included sports and recreation related organisations (21 per cent), community service organisations (19 per cent), education related institutions (15 per cent) and religious organisations (10 per cent).

¹¹ Based on sample data provided by ASIC on 3 November 2006.

¹² S Woodward and S Marshall, *A Better Framework: Reforming Not-For-Profit Regulation*, The University of Melbourne, available at: <http://cclsr.law.unimelb.edu.au/not%2Dfor%2Dprofit/finalreport>. Accessed 25 August 2008.

ATTACHMENT C

State and Territory regulatory requirements for incorporated associations and fundraising¹

	NSW	QLD	SA	TAS Incorporation	VIC	WA	ACT	NT
Eligibility	5 or more members	7 or more members Special resolution	Authorised by association rules	Authorised by association rules	Majority vote	5 or more members Advertisement of application	5 or more members Majority vote	5 or more members Authorised by association rules
Association Rules	Required at Incorporation	Required at Incorporation or model rules	Rules of association carry over	Required at Incorporation or model rules	Required at incorporation	Required at Incorporation	Required at Incorporation or model rules	Required at Incorporation or subject to model constitution
Public Officer(s)	Required (residency restrictions apply)	Required	Required (residency restrictions apply)	Required	Required (residency restrictions apply)	Subject to Incorporated Rules	Required (residency restrictions apply)	Required (residency restrictions apply)
Management Committee	Required – subject to incorporated rules	Required	Required – subject to incorporated rules	Not required	Required – subject to Incorporated rules	Required – subject to Incorporated rules	Required – at least 3 members	Required – subject to Incorporated rules

¹ The relevant State and Territory legislation is the *Associations Incorporation Act 1984* (NSW) and *Charitable Fundraising Act 1991* (NSW); *Associations Incorporation Act 1981* (Qld) and *Collections Act 1966* (Qld); *Associations Incorporation Act 1985* (SA) and *Collections for Charitable Purposes Act 1939* (SA); *Associations Incorporation Act 1964* (Tas) and *Collections for Charities Act 2001* (Tas); *Associations Incorporations Act 1981* (Vic) and *Fundraising Appeals Act 1998* (Vic); *Associations Incorporation Act 1987* (WA) and *Charitable Collections Act 1946* (WA); *Associations Incorporation Act 1991* (ACT) and *Charitable Collections Act 2003* (ACT); and *Associations Act 2005* (NT). The Treasury acknowledges the assistance of the Department of Families, Housing, Community Services and Indigenous Affairs in the compilation of this table.

Financial reporting								
Reporting	'Proper' Account Statement required at AGM	Account Statement required at AGM	Account Statement required	'Correct' Account Statement required at AGM	'Accurate' Account Statement required	Account Statement required at AGM	Account Statement required at AGM	Account Statement required at AGM
	Lodgement with Director General	Audit by a non managing member	Audited by a registered agent	Audit required by registered agent	Audit required for 'Prescribed' associations		Audit required by a non officer of the association	Audit required by a non officer of the association
			Lodged with the Commission	Minister may exempt organisations			Prescribed associations must use a registered agent	Prescribed associations must use a registered agent
Registration	Required – no application fee	Required	Required – no application fee	Fundraising Required for non incorporated organisations and individuals	Registration for all fundraisers	Required – no application fee	Required	Not required
		Separate applications for door to door, street and special support collection	Separate applications for entertainment and collection	Limitations on employment remuneration and soliciting hours	Detailed rules on collection	Subject to advisory committee's consideration of effectiveness		

Exemption	Religious organisations and associated bodies	Minister can deem charities exempt	No exemptions	Charities with a valid registration in another jurisdiction	Ministers can deem charities exempt	Education of environmental organisations	Collections of less than \$15,000	Permit required for lotteries over \$5,000
					Education or religion organisations		Education or religious organisations	Recognition of permits from other States
					Collections of less than \$10,000			
					Permit required for lotteries over \$5,000			