

# ***NONPROFIT ROUNDTABLE***

## ***Promoting Community Wellbeing***

### **NATIONAL ROUNDTABLE OF NONPROFIT ORGANISATIONS**

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## **NONPROFIT REGULATION REFORM PROGRAM**

***An initial statement by the National Roundtable of Nonprofit Organisations***

*Released May 2004*

### **INTRODUCTION**

Australia's nonprofit sector consists of a huge variety of organisations. Nonprofit organisations are the major providers of community services, sport and the representation of collective interests. They are significant providers of education and health services, arts and culture and hospitality services. They are the exclusive providers of religious services. The nonprofit sector encompasses a much wider set of organisations than those traditionally called 'charities'.

There are as many as 700 000 nonprofit organisations. About 320 000 are incorporated as separate legal entities and about 35 000 employ over 600 000 paid staff and involve over 4 million volunteers. These organisations contribute about 3.3% to GDP (4.7% when the value of volunteer labour is added in), but make an even more important contribution to our society and democratic political system.

The subject of this statement is the regulation of nonprofit organisations. Unlike business (or 'for-profit') organisations, nonprofits are typically constrained from distributing any profits made by the organisation to its members. The purpose or motivation for making the profit is to further the organisation's mission, rather than to pay dividends to members. Most nonprofits are governed democratically, with each member having a vote of equal value.

As with the government and business sectors, there are many differences between nonprofit organisations, differences in size, in activities, in the resources they consume. Nonetheless, they share some fundamental similarities, the product of their origins as expressions of collective action, either for members of the collective or for the benefit of others.

This means that nonprofit organisations operate in some fundamentally different ways to business and government organisations. They rely considerably on the voluntary contributions of money and time by their members and other supporters. But their members and supporters cannot hope for financial reward from their contribution; their motives are entirely different to those who invest time and money in business.

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Governments recognise these differences by treating most nonprofit organisations differently to business enterprises in the tax system. They also provide a variety of different mechanisms for their incorporation and regulate their fundraising. These laws and regulations are designed to assist nonprofit organisations, by reducing their costs, by protecting their members and directors, and by encouraging donations by assuring the public.

Australia's nonprofit sector is large by international standards. It has grown and changed considerably over the two hundred or so years since European settlement. At this present juncture, many parts of the sector face considerable challenges to adapt to a dramatically changing environment. While there is some evidence of renewal and growth in some parts of the nonprofit sector, it is also clear that many parts are in decline. It is possible that the wellsprings of collective action are drying. This should be a matter of concern, as a society with a weakened nonprofit sector would have a dramatically reduced capacity for regenerating social capital, for social innovation and policy renewal.

*One thing that is certain is that the existing legal framework and regulatory environment of the nonprofit sector is in need of fundamental overhaul. It is time to provide a clear, consistent and coherent framework based on sound public policy considerations.*

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. This proliferation imposes unnecessary complexity and duplication on both the sector and on governments. Fundraising is equally bedevilled by a proliferation of regimes across states and territories.

But it is in tax law that the greatest confusion is to be found. 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.

The Corporate Law Economic Reform Program (CLERP) developed by the present Treasurer has delivered significant regulatory improvements for business and the community. There is a strong case for a similar program for the reform of nonprofit law and regulation. This statement mirrors the thrust of CLERP, but is altered to suit the situation of nonprofit organisations.

The National Roundtable of Nonprofit Organisations (Nonprofit Roundtable) has been formed by peak organisations with a membership comprising tens of thousand of nonprofit organisations from many fields of activity. The Nonprofit Roundtable has identified reform of the legal and regulatory environment of nonprofit organisations as a priority. To this end, it has determined to establish a Working Party to advance a Nonprofit Regulation Reform Program. This statement, adopted by the Nonprofit Roundtable at its March 2004 meeting, will guide the Working Party.

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## **1. THE DIRECTION OF NONPROFIT REGULATION REFORM**

The Nonprofit Regulation Reform Program involves a fundamental review of key areas of regulation that affect nonprofit organisations and their activities. The objective of the Program is to ensure that nonprofit regulation is consistent with promoting a strong and vibrant nonprofit sector and provides a framework that assists nonprofit organisations in adapting to change.

Towards this end, the Nonprofit Roundtable is proposing fundamental reforms to Australia's nonprofit organisation regulation – reforms that aim to facilitate a more appropriate regulatory environment. This reform program will be developed with the benefit of consultation with the community and the Nonprofit Regulation Reform Working Party – a group established by the Nonprofit Roundtable to advise on reform proposals.

Reform of nonprofit regulation should be an element of a Government's overall economic and social program. Unnecessary and inappropriate regulation acts as a constraint on nonprofit organisations. Its rationalisation, and in some cases removal, will assist the formation of new nonprofit organisations and help existing nonprofits better to pursue their mission.

The stronger focus by governments on the effect of regulation on financial markets and the creation of a favourable climate for business investors has not been matched by similar progress in the nonprofit sector. Some of these reforms have inadvertently increased inappropriate regulation of nonprofit organisations.

*The objective of the Program, therefore, is to promote nonprofit organisations and their activities leading to important economic and social outcomes including increased employment, volunteerism, capacity building, enhancing efficiency in the delivery of services, integrity and donor confidence. Nonprofit regulation should be revamped to provide a clear and consistent framework which reflects the contemporary economic environment and encourages nonprofit organisations, large and small, to create positive social outcomes, jobs and community capacity building.*

## **2. KEY FACTORS DRIVING CHANGES TO NONPROFIT REGULATION**

### **2.1 Law has not kept pace with change**

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

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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.

*Australia must have a regulatory environment that promotes nonprofit enterprise, integrity and funder confidence.*

## **2.2 The Demographic Change**

Australia's ageing population poses one of the most pressing social issues of this century. Nonprofit organisations play a significant role in the delivery of services to older Australians including medical, aged care, domiciliary nursing, retirement financing and day to day living services, as well as providing socially beneficial activities through clubs, associations and churches.

The distribution of wealth from the baby boomer generation is also a major phenomenon. Bequests to nonprofit organisations or bequests establishing philanthropic foundations have traditionally been the most efficient form of nonprofit funding.

It is vital that we have a regulatory framework that permits nonprofit organisations to respond to the challenges posed by changes due to Australia's ageing population and to provide bequest mechanisms that are attractive to those who wish to contribute to the community.

## **2.3 Unlocking Capital for new challenges**

Capital has always proved problematic for nonprofit organisations both in maintaining a sufficient supply as well as redirecting surplus capital. The inherent nature of being non-surplus distributing organisations means that capital is difficult or impossible to attract from the commercial capital markets and the law guards the redirection of nonprofit capital from its original use.

Australia's demographic changes will require substantial new capital investments particularly in the health related fields in which nonprofit organisations play a vital role. Innovation in facilitating nonprofit organisations to access the commercial capital markets as well as traditional capital funding activities such as bequests, philanthropic foundations and capital appeals will be necessary.

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Demographic changes and the consequent social policy adjustments also bring redundancy of old institutions (eg large physical ‘institutions’ being replaced by smaller community facilities, hospitals being replaced by day surgery) and diverting capital to new uses in a timely and efficient manner will be required. Where nonprofit capital is transferred into the commercial markets, fair market value must be paid and redirected back into the nonprofit sector for community purposes.

### **3. FOCUS AND PRINCIPLES FOR NONPROFIT REGULATORY REFORM**

The focus of the reform agenda is to ensure that nonprofit regulation facilitates the mission of nonprofit organisations. The key principles underlying this review are as follows:

#### **3.1 Sector Difference**

While nonprofit organisations exist in a market economy, the market does not have exactly the same regulating influence as it does for commercial enterprise. As well, many of the ways nonprofit organisations “fail” their stakeholders are different to the ways for-profits fail. These differences need to be appreciated in regulating nonprofit activities. They call into question the appropriateness of doing so through commercial regulation and highlight the unintended consequential effects of commercial regulation. CLERP and The New Tax System have imposed a number of unintended consequences and unnecessary complexities on nonprofit organisations.

#### **3.2 Sector Evolution**

Any regulatory framework needs to be sufficiently flexible so that it does not impede nonprofit organisations in the evolution of their mission and activities. Our rapidly changing national economy requires not only resilient commercial markets, but also a nonprofit sector that can adapt to changing circumstances. As a society we face many challenges. There is a need to create an environment that encourages and facilitates both the transformation of existing, and the formation of new, nonprofit organisations, organisations that will find new ways of addressing those challenges.

#### **3.3 Stakeholder Protection**

Nonprofit organisations require the trust of members, funders, donors and the wider community in order to be able to operate efficiently in an Australian market economy. The cost-effective monitoring of nonprofit organisations is the key to maintaining and enhancing such trust.

Regulation should be cognisant of the differences between small and large organisations in requiring the public provision of information and between less

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and more sophisticated members, funders, donors and other stakeholders in ability to access and analyse information.

### **3.4 Information Transparency**

Disclosure is a key to promoting a more efficient and sustainable environment for nonprofit organisations. Disclosure of relevant information enables trust and appropriate funding decisions to be enhanced. Different levels and types of disclosure may be required for different parties and levels of sophistication. There is a particular need for information to be disclosed in ways that answer the questions that those interested in nonprofit organisations are likely to have. Current forms of disclosure, based on the reporting requirements of for-profit entities are far from satisfactory.

### **3.5 Cost Effectiveness**

The benefits of nonprofit regulation must outweigh its associated costs. The regulatory framework should take into account the direct and indirect costs imposed by regulation on nonprofit organisations and the community as a whole.

The regulatory framework for nonprofit organisations needs to be well targeted to ensure that the benefits clearly exceed the costs. All legislation should be assessed before enactment to ensure such an outcome.

Enterprising nonprofits need to explore innovative fundraising methods. A flexible and transparent framework for regulation and reporting will considerably aid this sort of innovation.

### **3.6 Ethics and Compliance**

Clear guidance regarding appropriate behaviour and swift enforcement if breaches occur are key elements in ensuring that the nonprofit sector functions optimally.

The Government must be committed to the strong and effective enforcement and facilitation of nonprofit regulation and provide adequate resources to agencies tasked with such responsibilities.

Fostering an environment that encourages high standards of practice and ethics must be a central objective of the regulatory environment, as well as effective enforcement.

### **3.7 Ensuring Availability of Appropriate Professional Advice**

Most people seeking to form a nonprofit organisation will seek professional advice, from an accountant or a solicitor. Many existing nonprofits also seek advice and assistance. Sensible, well-informed advice is frequently not available,

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as few professionals are familiar with the intricacies of the laws and regulations that apply to nonprofit organisations.

Attention needs to be given to ways of ensuring that the best possible advice is available to those seeking to form or to run nonprofit organisations. A simplified regulatory environment will assist.

#### **4. REFORM AGENDA**

Proposals developed as part of the Nonprofit Regulation Reform Program will apply the principles set out above in order to promote social and economic development. The Program will be progressed through a consultative process involving the nonprofit sector, its members, funders, donors and the wider community. The consultation process will proceed via the progressive release of discussion papers on the five topics listed below. After wide circulation of reports and the receipt of comments, a single report including recommendations for action will be released.

##### **4.1 National Law and Regulation**

Many nonprofit organisations, in common with commercial enterprises operate nationally to be sustainable and effectively perform their mission. Just as company and securities laws regulated by different state jurisdictions were inappropriate in a modern financial market, so are state laws relating to a number of nonprofit activities.

Proposals for a national regulator and regulatory frameworks will facilitate capital raising and support for nonprofit organisations and improve trust in and facilitation of nonprofit enterprise.

##### **4.2 Support and Fundraising**

Reform proposals will facilitate more cost effective raising of capital by removing impediments to fundraising, particularly the chaotic state based regulation of such activities.

Proposals to remove impediments to volunteering and its effective encouragement will be addressed to enable the sustainability of many vital community services underwritten by the nonprofit sector.

##### **4.3 Corporate Structures**

Reform proposals will address the suitability of present corporate structures for nonprofit enterprise and propose effective additional structures to cater for

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emerging innovations and neglected small grassroots groups. The aim of the proposals will be to ensure that regulation acknowledges the special characteristics of nonprofit organisations, facilitates the development of new forms of nonprofit enterprise and encourages innovative activities amongst large and small organisations.

#### **4.4 Accounting Standards**

Proposals for reform need to give recognition that nonprofit organisations have different accounting information users with vastly different levels of sophistication than commercial entities. The present patchwork of generic accounting standards and isolated specific standards do not serve information transparency or assist effectively in maintaining, enhancing or effectively monitoring the trustworthiness of nonprofit organisations. At present, the benefits of present accounting practices do not exceed their costs.

The harmonization of commercial accounting standards with international standards should not be at the expense of nonprofit standards.

#### **4.5 Taxation**

To address the negative impacts of a complex, irrational and high compliance cost taxation system policies will be developed for a rational policy basis of taxation exemption and other fiscal incentives to encourage nonprofit enterprise. Consideration will be given to state as well as federal imposts to streamline taxation administration.

### **5. CONCLUSION**

Ensuring the effectiveness of Australia's nonprofit organisations in delivering the social and economic benefits of their missions is of vital importance. Driving nonprofit organisation growth and facilitating social economic development are national priorities.

*Significant reform and streamlining of Australia's nonprofit law and regulation is required. Developing a regulatory framework to replace a shaky scaffold will make a major contribution to achieving Australia's economic and social goals.*

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## **ATTACHMENT**

### **THE NATIONAL ROUNDTABLE OF NONPROFIT ORGANISATIONS**

In October 2002, the National Roundtable of Nonprofit Organisations (the Nonprofit Roundtable) was formed by a group of committed national nonprofit organisations and peaks to bring together the collective views, voices and experiences of the nonprofit sector in Australia. The aim of the Nonprofit Roundtable is to promote the general wellbeing and advancement of the community. It does this by presenting an effective voice to the Australian community on common and shared issues affecting the contribution, performance and reputation of nonprofit organisations, as part of the third sector.

The initial participants of the Roundtable include:

Philanthropy Australia  
Fundraising Institute of Australia  
Sport Industry Australia  
ArtsPeak  
Third Sector Research Institute (UTS, QUT, Deakin University)  
National Council of Churches in Australia  
ACOSS  
ACROD  
Aged and Community Services  
Australian Conservation Foundation  
Australian Consumers Association  
Australian Council for Overseas Aid  
Australian Society of Assoc Executives  
Consumers Health Forum  
FECCA  
Jobs Australia  
National Council of Independent Schools Association  
Volunteering Australia

For the first time ever the Nonprofit Roundtable brings together organisations involved in the sector's funding/financing area, research and nonprofit endeavour across the broadest spectrum of activity. It is providing a unique opportunity to present the sector, its issues and its diverse and significant contribution to the Australian Community.

Enhancing the sector's reputation and recognition and greatly improving the infrastructure underpinning the sector are key priorities.

During 2004 participation will be greatly expanded to include all national nonprofit peak organisations and to involve nonprofit bodies generally.