PHILANTHROPY
Australia

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Patrons
Sir Gustav Nossal AC CBE
Lady Southey AC

Committee Secretary
Senate Economics Committee
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Sir/Madam

Philanthropy Australia welcomes the opportunity to make a submission to the Senate Standing Committee on Economics Inquiry on disclosure regimes for charities and not-for-profit organisations

Philanthropy Australia is the national peak body for philanthropy and is a not-for-profit membership organisation. Our members are major philanthropic donors, being trusts, foundations, corporations, families and individuals who want to make a difference through their own philanthropic giving and to encourage others to become philanthropists. Our mission is to represent, grow and inspire an effective and robust philanthropic sector for the community.

Philanthropy Australia recommends:

- That the term nonprofit / not-for-profit organisation be replaced with the "Community Benefit Entity.
- That the Australian Government implement the Standard Chart of Accounts and data dictionary for Community Benefit Entity reporting developed by Prof. Myles McGregor-Lowndes, Queensland University of Technology.
- That the Australian Government work with the States to develop and promulgate a Community Benefit Entity financial reporting regime that allows for differential financial reporting based on assets, revenue <u>and</u> the level of public accountability expected of the Community Benefit Entity.
- Ideally, a Community Benefit Entity financial reporting regime would differentiate between Community Benefit Entities established for charitable purposes and those established for community purposes such as sporting clubs, private clubs and membership services organisations.

Philanthropy Australia supports the introduction of harmonised, consistent financial reporting requirements for Community Benefit Entities, no matter what the basis of their incorporation.

We trust you find our response useful, and welcome the opportunity to discuss any aspect of the response with you.

Yours sincerely

Gina Anderson
Chief Executive Officer

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Australia

Submission to the Senate Standing Committee on Economics Inquiry on disclosure regimes for charities and nonprofit organisations

by Philanthropy Australia

28 August 2008

Philanthropy Australia welcomes the opportunity to comment on the Senate Standing Committee on Economics Inquiry on disclosure regimes for charities and not-for-profit organisations Terms of Reference as follows:

(a) the relevance and appropriateness of current disclosure regimes for charities and all other not-for-profit organisations

(b) models of regulation and legal forms that would improve governance and management of charities and not-for-profit (NFP) organisations and cater for emerging social enterprises.

(c) other measures that can be taken by government and the not-for-profit sector to assist the sector to improve governance, standards, accountability and transparency in its use of public and government funds

Philanthropy Australia is the national peak body for philanthropy and is a not-for-profit membership organisation. Our members are major philanthropic donors, being trusts, foundations, corporations, families and individuals who want to make a difference through their own philanthropic giving and to encourage others to become philanthropists. Our mission is to represent, grow and inspire an effective and robust philanthropic sector for the community.

Community Benefit Entity
The term "not-for-profit" creates a perception that profit is not necessary to these organisations, and that profit or lack of it, is a defining factor. While we do need these organisations to be sustainable, properly capitalised and funded, the term "not-for-profit" is misleading as profit is not *the* issue.

In other work with AASB to define "not-for-profit organisations" Philanthropy Australia has recommended using the term "Community Benefit Entity". The "Community" in this context can then be as large or as small as the various stakeholders require and would overcome the existing confusion in terminology and application to Public or Private Sector entities.

We suggest that "Community Benefit Entity" would be a better term to describe these organisations whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective, rather than for a financial return to equity holders.

Philanthropy Australia recommends:

- That the Australian Government implement the Standard Chart of Accounts and data dictionary for Community Benefit Entity reporting developed by Prof. Myles McGregor-Lowndes, Queensland University of Technology.
- That the Australian Government work with the States to develop and promulgate a Community Benefit Entity financial reporting regime that allows for differential financial reporting based on assets, revenue <u>and</u> the level of public accountability expected of the Community Benefit Entity. We emphasise that we recommend a separate Community Benefit Entity financial reporting regime, <u>not</u> the inclusion of specific "Community Benefit Entity" paragraphs in Accounting Standards developed on a sector neutral basis.
- Ideally, a Community Benefit Entity financial reporting regime would differentiate between Community Benefit Entities established for charitable purposes and those established for community purposes such as sporting clubs, private clubs and membership services organisations.

Philanthropy Australia supports the introduction of harmonised, consistent financial reporting requirements for Community Benefit Entities, no matter what the basis of their incorporation. Philanthropy Australia believes this harmonisation will be encouraged by the development of an Australian financial reporting regime for Community Benefit Entities.

(a) the relevance and appropriateness of current disclosure regimes for charities and all other not-for-profit organisations

Philanthropic funders, business and individual donors, government regulators and charitable organisations alike are hampered by the lack of consistency in accounting categories and terms across Australia's Community Benefit Entity sector. Unlike some OECD countries, Australia does not provide a set of accounting standards specifically for Community Benefit Entities. While the sector relies heavily on income from government grants and tenders and philanthropic grants, and is increasingly being used by government for the outsourcing of service delivery, analysis by the Centre of Philanthropy and Non Profit Studies at Queensland University of Technology discovered major inconsistencies in the application and acquittal documentation across government departments. The study examined grant documentation from 24 government departments and discovered 129 different revenue line items and 836 different expense line items, with difference occurring both in descriptions and in the accounting treatment for the same kind of expenses. In some cases, there were major inconsistencies between different funding programs within the same department. Although no comprehensive study has been produced into the different financial and accounting terms used by philanthropic foundations, we know that they too do not use common application forms or standard definitions.

The absence of agreed standards and consistent reporting obligations means that Community Benefit Entities can define their costs in different ways, which may not accurately reflect their activities. This actively inhibits the useful collection and aggregation of financial data for the Community Benefit Entity sector, and makes accurate comparisons between organisations impossible; there is no way to assess the financial efficiency of an individual organisation, and there are no benchmarks of efficiency for the sector.

Calls for greater accountability and transparency can in part be attributed to the lack of consistency in accounting categories and terms across Australia's NFP sector. This lack of accepted standards substantially increases the compliance costs for Community Benefit Entities, particularly the large number which receive funding from more than one source. As accounting systems are designed to record financial information in one format, unnecessary time and financial outlay must be spent on manually recalculating expenses according to the requirements of each funder.

Tax Status in the Community Benefit Entity Sector
Given the complexity of the Community Benefit Entity sector, it is worth putting some clarification around the sector.

I believe it is important to recognise their essential differences from profit-making entities: in a for-profit organisation, the quality of the widgets or services provided determines the quantity of the revenues. However, in a Community Benefit Entity the quality of the widgets or services provided fulfils the mission. It is the quality of relationships which determines the quantity of the revenues. The organisation's mission therefore is a critical element of the Community Benefit Entity, not only for its tax status, but because it is the mission that inspires people to donate. The requirement for a 'narrative' becomes paramount.

Those organisations classified as part of the Community Benefit Entity sector include charities; foundations and trusts; arts and culture organisations; environmental organisations; sports associations and clubs, independent schools, some hospitals membership associations; trade unions; NSW and ACT clubs; etc.

There are two primary tax status issues that have significant impact on the classification of organisations within the Community Benefit Entity sector.

The first is Tax Concession Charity status (formerly known as Income Tax Exempt Status or ITEC) which is granted by the Australian Tax Office to those community benefit entities that are deemed to be "charitable" under law and are therefore not liable for taxation. Community benefit entities that are not deemed to be "charitable" include sporting organisations; political organisations; private organisations; most Membership bodies; and those organisations under government control such as public schools.

The second tax issue is Deductible Giving Recipient (DGR) status, which allows a donor to the community benefit entity to receive a tax deduction on their donation. There are two main types of DGR organisations. "Giving DGRs" are primarily Public/Ancillary Funds, Prescribed Private Funds (PPFs), community foundations, private and independent foundations and trusts, which make philanthropic grants and donations.

The other group are "Doing DGRs" or charities. The Australian Tax Office grants DGR status to:

- Public Benevolent Institutions: charities set up for the direct relief of suffering ie. they are not preventative
- Universities; TAFEs; School Building Funds and Education Scholarship Funds
- Libraries and Museums
- Health Promotions organisations

The Federal Minister for the Arts grants DGR status to arts and cultural organisations through the Register of Cultural Organisations; the Federal Minister for the Environment grants DGR status to environmental organisations through the Register of Environmental Organisations; and the Federal Minister for Family and Housing, Community Services and Indigenous Affairs grants DGR status to those organisations involved with harm prevention. In addition there are a number of organisations that have been specially listed through the Federal Parliament such as the RSPCA; Landcare Australia Limited; Foundation for Regional and Rural Renewal; Amnesty International, Australia Conservation Foundation, to name a few.

Accounting Standards

The Australian Accounting Standards Board (AASB) has adopted International Accounting Standards, with one series of sector-neutral standards applicable to both for-profit and Community Benefit Entity entities. However, community benefit entities have very different characteristics to profit-making entities, including different objectives, stakeholders, budgetary considerations and operating environments. The same standards that are applied to businesses are not entirely suitable for Community Benefit Entity entities. Issues such as accounting for grants and donations and accounting for contributions-in-kind are specific issues faced by Community Benefit Entity entities. Encouraging appropriate accounting standards would enable greater transparency and standardisation, and would assist auditors to assess the financial health of community benefit entities.

The current lack of industry specific accounting standards for the Community Benefit Entity sector hampers the sector in several demonstrable ways:

- Community Benefit Entities are currently able to define their expenditure in various ways, which may or may not accurately reflect their activities. This impedes the collection and aggregation of financial data for the Community Benefit Entity sector, making accurate comparisons between organisations impossible. At present we have no way to accurately and objectively assess or benchmark the financial efficiency of an individual organisation.

- Accounting for grants, donations and contributions-in-kind presents specific challenges to Community Benefit Entities. For example, how do you compare Charity A which receives a monetary donation, buys blankets and gives them to the needy, with Charity B which receives a donation of blankets and gives them to the needy?

- By not recognising the value of volunteer hours, we underestimate and undervalue, the cost of running Community Benefit Entities, and therefore underestimate the costs of running the programs and services they provide.

- The compliance costs for Community Benefit Entities can be excessive, particularly for those which receive funding from more than one source. As accounting systems are designed to record financial information in one format, unnecessary time and financial outlay must be spent on manually recalculating expenses according to the specific requirements of each funder.

The current situation does not ensure transparency or assist in effectively monitoring the performance of community benefit entities. This is an issue, particularly in the light of increasing calls for the sector to become more efficient and accountable. A lack of effective monitoring also leaves the sector vulnerable to fraud and deception. A lack of clear measures leaves the sector without a means for driving economic savings and efficiency.

We believe that industry-specific accounting standards for the Community Benefit Entity sector would make significant progress towards streamlining accounting practices, giving guidance to community benefit entities in the development and transparency of their financial statements. This in turn would assist funders, both private and government. It would finally enable accurate measurement of the financial performance of Community Benefit Entities, and all parties would benefit significantly from the simplification of the financial reporting process.

PART (b): Models of regulation and legal forms that would improve governance and management of charities and not-for-profit (NFP) organisations and cater for emerging social enterprises.

We believe that a consistent financial reporting regime specifically for Community Benefit Entities that assists charitable Community Benefit Entities to explain what they are trying to do, and how they are going about it, will result in a more transparent, accountable and effective charitable sector. It would finally enable accurate measurement of the financial performance of Community Benefit Entities, and all parties would benefit significantly from the simplification of the financial reporting process.

That the Australian Government implement the Standard Chart of Accounts and data dictionary for NFP reporting.

The Standard Chart of Accounts was developed by Professor Myles McGregor-Lowndes, Centre for Philanthropy and NFP Studies at Queensland University of Technology, in association with the Queensland Treasury. It has been adopted by the Queensland State Government across departments and agencies and is soon to be adopted by the New South Wales Government. It aims to streamline financial accounting procedures, and reduce the costs of compliance to community sector organisations. Applied uniformly, it would ensure that reporting data collected is comparable and enable effective benchmarking of organisational performance throughout the sector which would be useful, to both government and community sector organisations.

Adopting a standard chart of accounts would make significant progress towards streamlining accounting practices, giving guidance to Community Benefit Entities in the development and transparency of their financial statements. This in turn would assist funders, both private and government. It would finally enable accurate measurement of the financial performance of Community Benefit Entities, and all parties would benefit significantly from the simplification of the financial reporting process.

That the Australian Government encourage the Australian Accounting Standards Board to develop appropriate accounting standards for the NFP sector, and provide support for the sector to adopt these standards.

The Australian Accounting Standards Board (AASB) has adopted International Accounting Standards, with one series of sector-neutral standards applicable to both for-profit and NFP entities. However, Community Benefit Entities have very different characteristics to profit-making entities, including different objectives, stakeholders, budgetary considerations and operating environments. The same standards that are applied to businesses are not entirely suitable for Community Benefit Entities.

Encouraging appropriate accounting standards would enable greater transparency and standardisation, and would assist auditors to assess the financial health of Community Benefit Entities. Providing support for the sector to take up such standards, including plain language guides, briefings and an information service, would greatly facilitate the sector's transition to a more appropriate and efficient system.

The majority of Philanthropy Australia's members are involved in the provision of funds for charitable purposes to Community Benefit Entities. When allocating their funds our members consider the financial viability and governance of the recipient, which can be assessed (in part) from the recipient's financial report. Philanthropy Australia's members are also acutely aware of the administrative burden placed on those community benefit entities that are *reporting entities* under Australia's current financial reporting regime. This is especially so of Community Benefit Entities incorporated under the *Corporations Act 2001* as companies limited by guarantee. Our response to the Senate Inquiry is therefore based on a desire to achieve a balance between the information needs of our members and the burden placed on community benefit entities when providing that information. We believe these needs would be best met and the burden alleviated by an Australian financial reporting regime developed specifically for private sector Community Benefit Entity entities.

In addition, we believe the introduction of an Australian financial reporting regime for private sector Community Benefit Entity entities will:

- enable greater emphasis to be placed on management's stewardship in Community Benefit Entity financial reporting;
- enable the development of sector specific public accountability criteria that can be used in applying a sector specific differential reporting regime;
- facilitate the introduction of a harmonised Community Benefit Entity reporting regime that can be adopted by all jurisdictions; and
- alleviate the confusion experienced by Community Benefit Entities in the current reporting regime

Furthermore, we believe this Community Benefit Entity financial reporting regime should apply to those entities covered by the general use of the term *not-for-profit organisations*, entities we describe as Community Benefit Entities.

Public accountability in the Community Benefit Entity sector

Philanthropy Australia thinks there is a need for an Australian financial reporting regime for Community Benefit Entity entities that allows for differential financial reporting based on assets, revenue and the level of public accountability expected of the Community Benefit Entity.

Community Benefit Entities have a different group of stakeholders and attributes that render them publicly accountable. The following matrix provides an indication of the degree of public accountability that can be ascribed to a Community Benefit Entity based on its operations. This matrix has been used as a starting point in developing our proposed three tier private sector financial reporting regime outlined below but is not directly comparable or relatable to those tables.

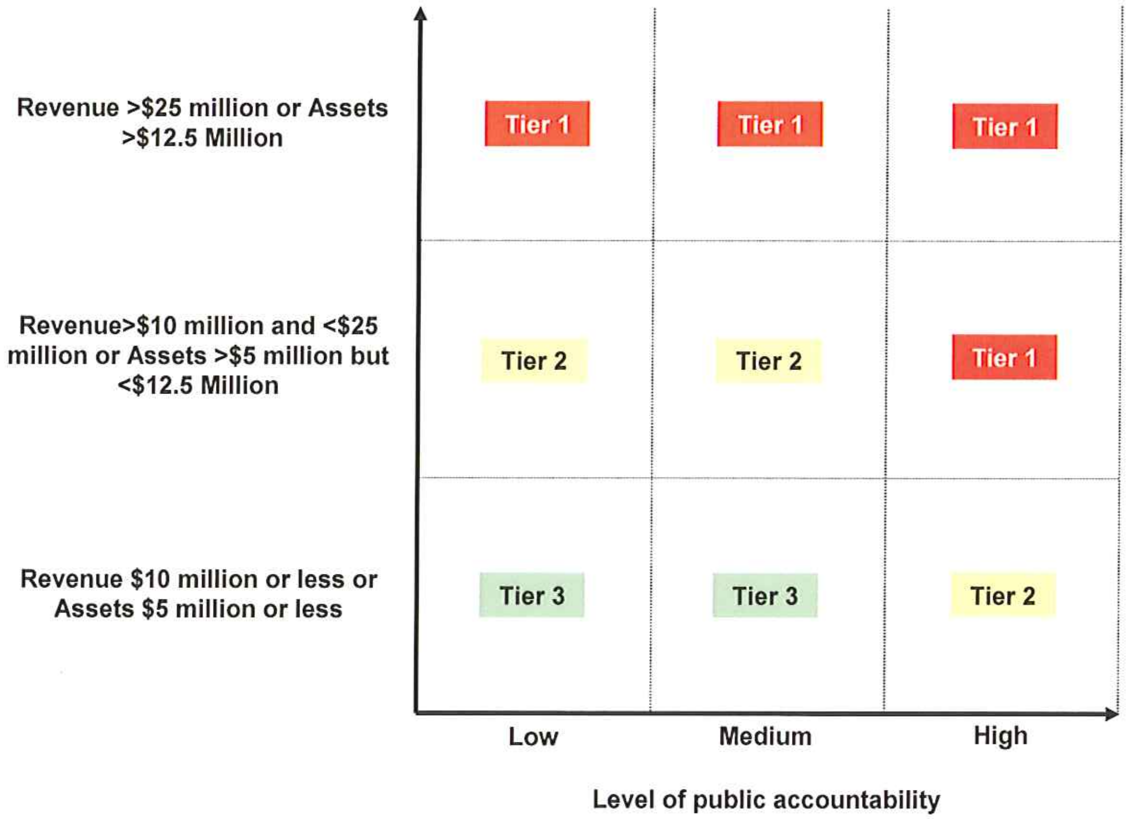
The public accountability matrix

		Level of Public Accountability (High, Medium, Low)		
Source of funds	Public appeals for donations			High
	Solicits for & receives bequests			High
	Government grants			High
	Grants from foundations		Medium	
	Sponsorships		Medium	
	One individual, family or corporation	Low		
Membership	Widespread geographically			High
	Management and membership separate			High
	Majority of members actively involved in day-to-day management	Low		
Volunteers & employees	High level of reliance on volunteers to achieve objectives; few if any employees			High
	Objectives achieved by employees; little volunteer involvement		Medium	
Other	Many stakeholders			High
	Few stakeholders other than members	Low to Medium		
	Income tax exemption	Low to Medium		
	Operate Australia wide and/or internationally			High
	Operate in limited geographic area (one suburb or country town)	Low to Medium		
	Significant community impact			High
	Impact limited to a specific community or one group within a community	Low to Medium		
	Represents a number of communities or affiliated bodies			High

We suggest the following as a basis for the development of an Australian financial reporting regime for private sector Community Benefit Entity entities.

<u>Form of reporting</u>	<u>Revenue</u>	<u>Assets</u>	<u>Public Accountability</u>
Tier 1: Compliance with all relevant requirements of an Australian financial reporting regime for private sector Community Benefit Entity entities for this tier	> $25 million	> $12.5 million	When a Community Benefit Entity has revenue and assets of these amounts it can be assumed it will have a high level of *public accountability*
Tier 2: Compliance with all relevant requirements of an Australian financial reporting regime for private sector Community Benefit Entity entities for this tier	> $10 million but < $25 Million	> $5 million but < $12.5Million	The level of disclosure in the financial report varies according to the level of *public accountability* of the entity
Tier 3: Compliance with all relevant requirements of an Australian financial reporting regime for private sector Community Benefit Entity entities for this tier	$10 million or less	$5 million or less	

The practical application of this regime is illustrated below.



PART C: Other measures that can be taken by government and the not-for profit sector to assist the sector to improve governance, standards, accountability and transparency in its use of public and government funds

Harmonisation of State Associations Incorporations Acts

Many Community Benefit Entities are incorporated under various State *Associations Incorporation Acts*. The requirement for their accounts to be prepared in accordance with accounting standards varies from State to State and (in some jurisdictions) according to the associations' revenue and assets. Under current legislation their financial information and/or reports are required to be lodged with the relevant State authority even if they are a national association.

In our response the Commonwealth Treasury's June 2007 Discussion Paper *Financial Reporting by Unlisted Public Companies,* Philanthropy Australia indicated its support for the introduction of harmonised, consistent financial reporting requirements for Community Benefit Entity entities, no matter what the basis of their incorporation or the State in which they are incorporated.

Sector Consolidation and Duplication

Critical to the vitality of the NFP sector is the passion of social entrepreneurs. Social innovation, new ideas and different approaches lead to the formation of new innovative organisations. Without the scrutiny of the ballot box or shareholders, philanthropy can encourage social entrepreneurs to try new things. This is an important aspect of philanthropy and provides a dynamic and innovative tension in the sector.

However calls for the consolidation and merger of community organisations are also strong. While it is impossible to accurately measure the sector's efficiency due to the lack of data, we know that a very large number of NFP organisations exist (700,000 in Australia, 360,000 of which are incorporated) and that there is heavy duplication in many areas (BRW Magazine in 2007 pointed out that there are 20 children's charities serving a relatively small number of children with cancer, and argues that there is "a strong case for some of them to get together and at least merge their back offices, if not the charities themselves"). The Giving Australia report in 2005 found that duplication and wastage amongst charitable organisations was a strong concern for potential donors. However, the myriad of different legal structures for NFP organisations and the lack of tools, financial assistance and resources for mergers makes it a daunting prospect for most organisations.

While the Government's approach to funding has put pressure on NFP Organisations, in general, organisational capacity has been squeezed rather than motivated towards more effective consolidation.

In the For Profit sector it is typically Boards motivated by price signals that drive consolidation. In the NFP sector the Boards of Directors are the custodians of the mission of each organisation. However, options to consolidate organisations are often not on their radar. In future, the combination of better data, based on consistent accounting standards, and better training for NFP Directors would assist in the consideration of mergers and out sourcing as part of strategic review processes in NFP organisations.