

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

28 August 2008

Dear Committee Secretary

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

We are delighted to provide a contribution to the above inquiry. We believe there is currently an opportunity to make a difference in the efficiency and relevance of reporting and regulation in the not-for-profit (NFP) sector.

PwC supports moves to facilitate a simpler reporting and regulatory system nationally. Our view is that the entity's activities (rather than its legal type) should determine what additional governance and regulatory obligations are required. In our view, organisations receiving public funds by way of donations or government grants have greater accountability to the public. Other member based NFP organisations have only the same public accountability as proprietary companies. We would support a disclosure regime encompassing all charities, and other large NFPs with greater than \$25 million of assets or \$12.5 million of revenue. The financial information should be audited. Other small NFP organisations should have the same exemptions from reporting as small proprietary companies.

We support regulatory change which is focused on reducing the burden of differences in local, state and federal legislation and reporting requirements relating to NFPs and government grants. We support the creation of a national regulatory body to oversee the established reporting and regulatory framework and the consistent application of agreed standards.

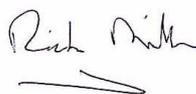
PwC recently conducted the Transparency Awards for the NFP sector (refer Appendix 1). In this we found quality of reporting in the sector to be highly variable. There is a need for a consistent base level of reporting by all those organisations with public accountability. We encourage development of specific financial and non-financial reporting guidance by a body such as the Australian Accounting Standards Board (AASB).

Our detailed comments are set out in the attached submission in line with the Committee's terms of reference, and we are happy to expand on any of the issues raised.

Yours faithfully



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Key points of our submission

- A simpler national system of regulation and reporting is needed to improve efficiency, relevance, transparency and governance.
- Organisations receiving public funds by way of donation or government grants have greater accountability to the public. Other member based NFP organisations have only the same public accountability as proprietary companies. Thus we would support a disclosure regime encompassing :
 - all charities,
 - other large NFPs with greater than \$25 million of assets or \$12.5 million of revenue.
 - The financial information should be audited.Other small NFP organisations should have the same exemptions from reporting as small proprietary companies.
- We support a national regulator to oversee the established reporting and regulatory framework and the consistent application of agreed standards, similar to the UK and NZ. The regulator could also be responsible for providing basic levels of training about the regulation and good governance practices of NFPs.
- The quality of reporting in the sector is highly variable. There is a need for a consistent base level of reporting by all those organisations with public accountability. We encourage development of specific financial and non financial reporting guidance by a body such as the AASB.

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

i. Are current disclosure regimes for not-for-profit organisations adequate?

We believe there is an opportunity to make a difference in the efficiency and relevance of reporting in the not-for-profit sector. At present, the disclosure requirements of charities and other not-for-profit (NFP) organisations depend on:

- the entity's legal form of incorporation and the associated reporting requirements under the relevant statutory law, for example the *Corporations Act 2001* or any of the state legislations for incorporated associations

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- any specific legal reporting requirements dealing with an authority to raise funds from the public, for example the *NSW Charitable Fundraising Act*.

Legislation from state to state for example is inconsistent, and in some states is out of date. Organisations are increasingly operating nationally.

The current disclosure regime for charities and all other NFP organisations should be streamlined and be nationally consistent. In our view, the activities of the entity, rather than its legal type or state, should drive its disclosure obligations. In our view, organisations receiving public funds by way of donations or government grants have greater accountability to the public. Other member based NFP organisations have only the same public accountability as proprietary companies. We would support a disclosure regime encompassing all charities, and other large NFPs with greater than \$25 million of assets or \$12.5 million of revenue. The financial information should be audited. Other small NFP organisations should have the same exemptions from reporting as small proprietary companies.

We believe charities should be differentiated from other community organisations such as clubs and associations, for the reasons described below.

Charities

There is great public interest in charities, particularly from those who have provided funds, whether through donations or by public funding. While some charities are incorporated as companies limited by guarantee, others are different entities such as trusts. However, it is a charity's activities that drive public interest, not its entity 'type'.

We believe the reporting and governance requirements of charities should be aligned to this public interest. This means greater transparency and accountability about the way public or donated funds are spent is needed. It may therefore be appropriate to require all registered charities with deductible gift recipient status (DGR) to prepare a sector specific annual report. These could be lodged with a new regulatory body and, if applicable, with ASIC.

The annual report could include a financial report similar in length and simplicity as a concise report used for corporates. It should focus on metrics important to charities for example, fund raising costs. Non-financial information such as the charities mission and achievements towards that mission would also be essential. The financial information should be audited.

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A body such as the AASB should consider the format of the reporting of those entities undertaking charitable activities. This is important to ensure the required information meets the needs of the users of the report including government grant providers. The AASB could be responsible for formulating reporting guidance which is not unduly burdensome to small charities, while at the same time reflecting the operational complexity of larger charities.

We would support the development of specific guidance, such as has been done in the UK with the *Accounting and Reporting by Charities: Statement of Recommended Practice*, and the Australian Institute of Chartered Accountants publication *Enhancing Not-for-Profit Annual and Financial Reporting*.

Other NFP organisations

Small NFP organisations

Many other NFP organisations are small registered clubs or associations. Their funding is provided by their members, who also enjoy the benefits of the association. We are not persuaded that there is great public benefit in these small associations preparing general-purpose financial reports.

We therefore recommend that they have the same exemptions from reporting as small proprietary companies incorporated under the *Corporations Act 2001* (ie consolidated revenue of \$25 million or consolidated assets of \$12.5 million). The level of paid employees is not an appropriate differentiation criterion, as NFP organisations often have a large number of part-time or voluntary workers.

Nationalising the legislation for associations would assist the operation of a threshold style test. Alternatively a more cumbersome approach would be to incorporate the thresholds in the various legislations.

The users of financial information about these associations (predominantly the members) are most likely to seek simple financial and governance information illustrating how their funds have been utilised. The constitution of such associations usually requires them to prepare such information or financial reports that members might need. It may also outline any audit requirements of that information.

However, if the government makes a grant to such an association, it will usually be conditional upon some level of reporting regarding the grant funds and a potential audit acquittal. The government is in a different position to other donors as it is able to specify the reporting it requires. Where the grant is a small amount the compliance costs should not outweigh the benefit of receiving the grant. A simplified national approach to

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documentation required to receive a grant and report on the use of funds is worth considering.

Large NFP organisations

We believe large NFP organisations, which are not charities, should be subject to similar reporting requirements as for-profit entities with consolidated revenue of \$25 million or consolidated assets of \$12.5 million.

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

A national disclosure regime would reduce the administrative burden on NFPs who increasingly operate across state borders, encountering different legislative requirements in each state and territory. It would ensure consistency of reporting obligations for those competing for national funds. It also will take away the need to update the various out of date state/local legislations.

Smaller charities may have increased compliance costs if they do not currently prepare a financial report or have an audit. However, we believe this is necessary to retain confidence in such entities with high public accountability.

iii. Would a standardised disclosure regime assist not-for-profit organisations who undertake fundraising activities, and who operate nationally, to reduce their compliance costs if it meant that they would only have to report on fundraising to a single entity (rather than reporting to each state and territory)?

Yes as they will have to comply with only one national system rather than various state systems.

iv. If there was to be a nationally consistent disclosure regime, should it apply across all not-for-profit organisations or should different regimes apply to different parts of the sector? For example, should charities be treated differently from other not-for-profit entities?

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In our view, organisations receiving public funds by way of donations or government grants have greater accountability to the public. Other member based NFP organisations have only the same public accountability as proprietary companies. We would support a disclosure regime encompassing all charities, and other large NFPs with greater than \$25 million of assets or \$12.5 million of revenue. The financial information should be audited. Other small NFP organisations should have the same exemptions from reporting as small proprietary companies.

Charities could be defined as those entities with a DGR and a registered charity status.

- v. If different regimes were to apply to different parts of the sector, how would this be determined and why? For example, would it be based on classifications – ie as a charity or deductible gift recipient – or their annual financial turnover or staffing levels (or some other proxy for size and/or capacity)?**

As per answer to iv) in our view, organisations receiving public funds by way of donations or government grants have greater accountability to the public. Other member based NFP organisations have only the same public accountability as proprietary companies. We would support a disclosure regime encompassing all charities, and other large NFPs with greater than \$25 million of assets or \$12.5 million of revenue. The financial information should be audited. Other small NFP organisations should have the same exemptions from reporting as small proprietary companies.

Charities could be defined as those entities with a DGR and a registered charity status.

- (b) (i) Does there need to be regulatory reform of the not-for-profit sector?**

There needs to be regulatory reform of the NFP sector to create a simple national system of incorporation, legislation and regulation.

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If so:

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

The key objectives of the reform should be the creation of:

- a nationalised legislative system which encourages transparency and accountability
- a national regulator to oversee the established reporting framework and the consistent application of agreed standards of governance and fund raising ethics
- The provision of basic education to facilitate a minimum level of competency about the legislation and good governance. In the charities sector this could be a requirement before approving DGR status.

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

We believe the sector is large enough to the Australian economy to require a national regulatory system.

➤ **Should regulatory reform apply to the whole not-for-profit sector, or only to segments of the sector? For example, to charities; to bodies receiving public funds, whether through grants or tax concessions; to bodies with a financial turnover about a specified threshold etc?**

See comments in a(i), (iv) and (v) above.

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

In the interest of national consistency, the reform should be driven by the Commonwealth through the national regulator and the AASB. This would overcome the current confusion and inconsistency of differing state regulations, and different reporting requirements depending on the type of government grant received or the different type of entity.

➤ **What sort of consultation should be conducted on the nature of any regulatory reform? How could input be facilitated from across the broad range of organisations who comprise the not-for-profit sector?**

We believe that listening sessions across the sector is a useful mechanism for conducting consultation. As the not-for-profit sector is staffed by volunteers and part-time workers

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rather than full-time employees allowing additional time for input will facilitate increased response levels across the sector.

- **Are there particular models of regulation and/or legislative forms that would be useful, in the Australian context, in improving governance and management of charities and not-for-profit organisations and in catering for emerging social enterprises? What are the perceived advantages and/or disadvantages of these models?**

Existing regulation in the UK and NZ should be considered in formulating Australian regulation – for example, the Charities Commission in the UK which regulates the administration and affairs of registered UK charities. This commission has been in existence for nearly 150 years and much could be gained from understanding its experiences.

We believe charities should be required to prepare a simple form annual report in which the financial information has been subject of an audit by a registered company auditor. It should also contain minimum levels of non financial information about the plan for activities and if they have been achieved. Other large NFP's with greater than \$25m revenue or \$12.5m assets should have similar financial reporting as large proprietary companies. Small NFP's should operate under their constitution and have the same exemptions as small proprietary companies.

ii. Should there be a single national regulator for the not-for-profit sector?

In our view there should be such a regulator. Further, if this regulator were to be attached to or part of ASIC, it should be clearly separated from the regulatory function for for-profit corporates.

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

Whilst the immediate focus should be on charities, we believe the national regulator should be responsible for the entire NFP sector. This will ensure the boundaries between charities and other NFP's are well understood.

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

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Yes, we believe the national regulator should be independent of government, similar to ASIC to serve the collective public good.

- **Where would the regulator be best located? For example, as a stand alone agency or located within an existing institution, such as the Australian Securities and Investment Commission.**

It could be located within ASIC to share existing infrastructure and avoid duplication of knowledge resources such as directors' registers. The body should however have its own resources dedicated only to the NFP sector.

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

We believe the national regulator should educate and advise the sector to facilitate growth in skills and competencies. It should also enforce to protect the public and government donors. The regulator should work with the AASB and others to create transparency in reporting of both financial and non-financial information.

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

It could be part of their role. For instance, the Charities Commission in the UK is responsible for determining the charitable status of charities.

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

Funding should be provided by the Federal government as it will be a national body.

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iii. Should there be a single, specialist, legal structure for the not-for-profit sector?

If so, would this be best achieved through:

- **A national legislation scheme, whereby current national and state and territory laws relating to the not-for-profit sector are harmonised into uniform law?; or**
- **The referral of powers from the states and territories to the Commonwealth, allowing for incorporation of current laws relating to the regulation of the not-for-profit sector, for example, incorporations Acts and fundraising Acts, into Commonwealth legislation?**
- **What should be the minimum features of any legal structure?**

Yes, we believe that a nationalised legislation scheme will create the benefits of harmonisation and assist in meeting the objectives of the reform as set out in b(i) above.

We are unable to comment on the legal structure.

(c) Other measures that can be taken by government and the NFP sector to assist the sector to improve governance, standards, accountability and transparency in its use of public and government funds

The quality of reporting in the NFP sector is highly variable. Some organisations produce good quality, transparent reporting in certain areas, but the general standard needs improvement in order to meet the information needs and expectations of all stakeholders.

Our view is that the reporting requirements of small NFPs, such as clubs and associations should be determined by their members, while large NFPs, which are not charities, should be subject to similar reporting requirements as for-profit entities. However, in the case of charities, certain areas of reporting such as governance, sourcing, application and cost of fundraising revenue, and non-financial performance measures need particular attention due to public interest in their activities. We therefore offer the following suggestions for measures that could be taken by government or charities themselves to improve reporting.

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Governance

Charities' governing bodies often struggle to find the most appropriately qualified, experienced and independent people to provide sufficient strategic input. In remote communities, for example, it can be difficult for the organisation to achieve community representation because the community members themselves lack the skills to manage or govern the organisation established to serve their needs.

We would support efforts to strengthen the governance of charities through the development of appropriate training for new and existing board or governing body members. "Appropriate training" means education to ensure they are aware of, and appropriately skilled to assume, the responsibilities of such a role. Training materials would need to be developed nationally and possibly be made available online through an existing regulatory body's website, to maximise accessibility.

Standards

The diverse nature of their activities, the stakeholders they impact, and the reasons for their existence make charities very different to for-profit entities. Any standards set and applied to the sector need to be appropriate, relevant and cognisant of the charity sector's differences to the for-profit sector.

In our view, a streamlined, national reporting framework and the consistent application of agreed standards would reduce costs, simplify reporting and increase efficiencies. This in turn will have the flow-on effect of improving and sustaining public trust in the sector.

Because of the diverse nature of charities' activities, it could be difficult to compare elements of performance regardless of whether standards existed. For example, the composition of fundraising costs differs from one charity to another. We therefore support a principles-based approach to the setting of standards for charities.

In relation to fundraising costs, rather than regulating what is or is not a fundraising cost, we suggest it is more appropriate for charities to be subject to a standard requiring disclosure of fundraising costs. It would then be the responsibility of the individual organisation to define and disclose what it includes in 'fundraising costs'. Any resulting variation in methodology would be offset by the increased level of transparency and relevance of disclosed information.

Accountability and Transparency

While efforts to improve governance and reporting standards for charities will clearly require effort and input from both Government and the sector itself, we believe there are

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other areas of reporting, that need greater accountability by, and more transparent disclosure from charities themselves in order to ensure public trust in the sector is sustained. Such areas include:

(a) Sourcing, application and cost of fundraising revenue

Charitable organisations rely on government funding, public fundraising or a mixture of both, but there is often no specific disclosure of this reliance in charities' annual reports. We encourage the development of a culture of transparency through open disclosure of the sources of funds raised (either through government funding or through public donations), how those funds have been applied, and the costs related to the fund-raising.

(b) Investments

Investments held by charities range from simple ones such as cash at bank, to the more complex, such as unit trusts, shareholdings and financial instruments. The funds for these investments will have come directly or indirectly from public donation or Government funding, resulting in public interest in the prudent management of these funds. More insightful disclosure about the investment strategies and policies of charities would increase transparency to stakeholders.

(c) Non-financial performance measures

It would be helpful if all organisations included their mission or vision statements, followed by at least a summary of their strategy, and their performance against that strategy in their annual review or annual report.

In light of the nature of charitable activities and the tendency for most programs and activities to run for extended periods, measurable performance targets and trend information would be a welcome enhancement to reporting in the sector.

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We believe that charities, as well as other NFPs who commit themselves to a transparent approach to their reporting will encourage trust and confidence in the NFP sector as a whole and enjoy benefits such as:

- increased awareness of their organisation and its underlying reason for existence
- increased board or governing body credibility
- better access to donations and grants
- more long-term stakeholders, including employees, volunteers and donors
- a better managed organisation.

Conclusion:

Our view is that a streamlined, national regulatory and reporting regime would reduce costs, simplify administrative burden and increase efficiencies and transparency in the NFP sector. This in turn will have the flow-on effect of improving and sustaining public trust in the sector.

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Appendix One – PwC Transparency Awards

PwC introduced the PwC Transparency Awards (the Awards), in collaboration with the Institute of Chartered Accountants in Australia (the Institute), to encourage ongoing improvement in the quality and transparency of reporting in the NFP sector. Before we did so, we consulted with – and received strong support from – the sector for the concept of setting measurable accepted benchmarks and consistency in reporting.

Organisations who met the following criteria were eligible for the Awards:

- Have deductible gift receipt (DGR) status
- Be endorsed by the ATO for charity tax concessions
- Have audited accounts
- Generate revenue >\$10 million
- Not be an educational institution or a religious institution (other than one directly related to the provision of charitable community work).

Thirty-six eligible organisations nominated themselves, providing their Annual Reports, other external reports and website contents for review. After the comprehensive review process was completed, each organisation received an individual feedback report with recommendations for improvement in their reporting content and presentation.

The jury consisted of Senator Ursula Stephens, Parliamentary Secretary for Voluntary Sector and Social Inclusion; Mr Rupert Myer, Chairman, The Myer Family Co Pty Ltd and Chairman of the National Gallery of Australia; Mr Michael Traill, CEO, Social Ventures Australia; and Mr Leon Gettler, senior journalist with *The Age*.

The jury's report summarising all findings and observations was made publicly available on the Awards website.¹

¹ www.pwc.com/au/transparencyawards