

## Response to Terms of Reference

### Definitions

The Senate Standing Committee is investigating the Not-For-Profit Sector. Organisations within this sector do not operate for the profit or gain of its members, whether these gains would have been direct or indirect<sup>1</sup>.

For the purpose of this submission, the Not-For-Profit sector comprises two distinct categories. They are:

- 1) Charities, including Public Benevolent Institutions
- 2) Social Enterprises

### Charities

*The characteristics of a charity are:*

- *It is an entity that is also a trust fund or an institution*
- *It exists for public benefit or the relief or poverty*
- *Its purposes are charitable within the legal sense of that term*
- *It is Non-Profit*
- *Its sole purpose is Charitable<sup>2</sup>*

Within this category are Public Benevolent Institutions. *The characteristics of a public benevolent institution are:*

- *It is set up for needs that require benevolent relief*
- *It relieves those needs by directly providing services to people suffering them*
- *It is carried on for the public benefit*
- *It is non-profit*
- *It is an institution*
- *Its dominant purpose is providing relief<sup>3</sup>*

The above definitions provided by the Australian Taxation Office indicate the inconsistency and contradictory nature of the sector. Specifically, a charity has a **sole** purpose that is charitable, thereby excluding advocacy and commercial activities. Whereas a Public Benevolent Institution has a **dominant** purpose in providing relief, which it allows it to carry on advocacy and undertake commercial activities that are inconsequential to the operations of the relief activities.

Another apparent contradiction is that currently government bodies are denied charitable status. Despite this some government controlled entities have been able to acquire Deductible Gift Recipient endorsement. Examples include hospital, hospital foundations, and some government controlled volunteer emergency groups.

### Social Enterprises

*Social enterprises are businesses set up to tackle a social or environmental need. Many commercial businesses would consider themselves to have social objectives, but social enterprises are distinctive because their social and/or environmental*

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<sup>1</sup> Australian Taxation Office, *Tax Basics for Non-Profit Organisation*, (2007)p1

<sup>2</sup> Australian Taxation Office, *Tax Basics for Non-Profit Organisations (2007) p4*

<sup>3</sup> Australian Taxation Office, *Tax Basics for Non-Profit Organisations (2007) p4*

*purpose is absolutely central to what they do - their profits are reinvested to sustain and further their mission for positive change.*<sup>4</sup>

*In the British context, social enterprises include community enterprises, credit unions, trading arms of charities, employee-owned businesses, co-operatives, development trusts, housing associations, social firms and leisure trusts.*<sup>5</sup>

Social enterprises may comprise of partnership between government, businesses and other stakeholders working for the benefit of the community.<sup>6</sup>

### **Recommendation 1**

That Government legislatively widen the characteristics of a charity. The inclusions should permit

- advocacy,
- activities that prevent poverty, sickness or distress, such as counselling,
- fundraising on behalf of government bodies.

It is further recommended that the Government legislate with a new Act, called the Charities Act, the following:

- a definition of charity that is adopted by all entities controlled by the Government and all entities controlled by all the State and Territory Governments
- responsibilities of office holders and key management personnel
- the public disclosures required by a charity to be disclosed publicly
- the public disclosures required by a charity to be submitted with an annual financial report to its regulatory body
- specify that a charity's regulatory body is the body that regulates the legislation under which the charity incorporated.
- The adoption of the reporting concept for public disclosures (outlined below)

### **Recommendation 2**

That all not-for-profit entities, excluding government bodies, be classified as either a charity or a social enterprise.

**2a** That within the category of charity that the terminology "Public Benevolent Institution" be removed and all charities be classified by purpose, into one of the existing Australian Taxation Office categories:

1. Charities for the relief of poverty, or sickness or needs of the infirm
2. Charities for the Advancement of Religion
3. Charities for purposes beneficial to the community

It is further recommended that, all "Charities for the relief of poverty, or sickness or needs of the infirm" be granted all current tax concessions eligible for Public Benevolent Institutions. It is recommended that criteria from the Fire Brigades Case and the Mine Rescue case be reviewed and appropriate government controlled bodies be classified as "Charities for purposes beneficial to the community".

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<sup>4</sup> Social Enterprise Coalition, downloaded 26 August 2008 from [www.socialenterprise.org.uk](http://www.socialenterprise.org.uk)

<sup>5</sup> *Social Enterprise* downloaded from Wikipedia 26 August 2008

<sup>6</sup> *Community Interest Companies Guidance: Overview of a community interest company*, downloaded 28 August 2008 from [www.cicregulator.gov.uk](http://www.cicregulator.gov.uk).

**2b** That within the category of social enterprises that all non-charity not-for-profit organisations be classified by distribution of gain, into one of the following categories:

1. Distribution of all gains to an endorsed income tax exempt charity
2. Other Distributions, including limited distributions to equity holders

It is further recommended that a social enterprise incorporated as a “Community Interest Company limited by guarantee” (as outlined below) which is a subsidiary to an endorsed income tax exempt charity be granted the same tax status as the parent entity, but a Community Interest Company that is a parent to an endorsed income tax exempt charity not be granted the tax status of the charity. Charities will be able to utilise profits from commercial activities that are for the benefit of the community, to reduce dependence on government funding.<sup>7</sup>

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

#### **Reporting Identity**

*There are two broad sources of authority which govern the preparation and presentation of financial reporting in Australia. The first are those prescribed through the legislative system in the form of Acts of Parliament or rules set by regulatory bodies. The second source of authority is the requirements established by the accounting profession<sup>8</sup>. Other professional bodies, such as the Fundraising Institute of Australia, require members to comply with their professional requirements.*

The accounting profession requires that financial reports are prepared using the concept of a reporting entity. *The concept requires that individual reporting entities be identified by reference to the existence of users who are dependent on general purpose financial reports for information for making and evaluating resource allocation decisions<sup>9</sup>. A general purpose financial report is a financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs<sup>10</sup>*

#### **Recommendation 3**

That Government legislate the concept of a reporting identity consistent with SAC 1 Definition of the Reporting Entity be adopted for all quantitative and qualitative disclosures required of not-for-profit entities. A general purpose public disclosure is only made to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy all of their information needs, thus reducing the reporting burden on small, grassroots community organisations.

#### **Not-For Profit Organisations Incorporated under State Government Legislation**

As noted in the background paper for the Committee there are many legal forms available for not-for-profits to be incorporated. Each legal form imposes differential

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<sup>7</sup> Refer to Commissioner of Taxation vs. Word Investments Ltd for further information on the carrying on of commercial activities by charities.

<sup>8</sup> Neville, KW, Sincock, G, Shapiro, I, *XYZ Model Financial Accounts 2008*, Moore Stephens, Melbourne.

<sup>9</sup> Statement of Accounting Concept 1 *Definition of the Reporting Entity*

<sup>10</sup> Statement of Accounting Concept 1 *Definition of the Reporting Entity*

public disclosures. For example the *Associations Incorporation Act (Tas) 1964* only requires financial statements deemed adequate by the auditor which must be audited, whereas if same organisation were incorporated under the *Associations Act (NSW) 1984* would be required to prepare an Income and Expenditure Statement, Assets and Liabilities Statement, Description of mortgages, charges and other securities affecting assets and Accounts disclosing the above for any trust of which the association is a trustee, but there is no mandatory audit. The lack of consistency between states, limits the comparability and transparency of not-for-profit entities incorporated under state based legislation.

#### **Recommendation 4**

That the Government seek the agreement of all State and Territory Governments to assume legislative responsibility for Incorporated Associations and Co-operatives.

#### **Recommendation 5**

That an Office for the Registrar of Corporations be developed within the Department of Housing, Community Services and Indigenous Affairs to regulate associations incorporated by Government legislation. It is further recommended that the Corporations (Aboriginal and Torres Strait Islander) Act 2006 be updated so the Registrar of Indigenous Corporations is replaced by the Registrar of Corporations. It is further recommended that the Office of the Registrar of Corporations continue with the mandate provided to the Office of the Registrar of Indigenous Corporations.

#### **Recommendation 6**

That the Government seek the agreement of all State and Territory Governments to harmonise fundraising requirements in each jurisdiction. Fundraising from the public by "Charities for the Advancement of Religion" be exempt from the requirements where the fundraising occurs on privately controlled property, including public spaces privately controlled.

#### **Recommendation 7**

That the Government resource peak bodies, professional associations, academic institutions and relevant parties to develop national standards of terminology and public disclosure for charities for qualitative and quantitative information which satisfies the reporting requirements of all State and Territory Government bodies.

### **(b) Models of regulation and legal form**

Despite the many legal forms that exist, some community based organisations have discovered that their incorporation options are limited. Specifically, where a large not-for-profit entity, decides to incorporate each separate branch, there is currently no legislation that allows the parent entity to appoint the Management Committee or Directors of the branch. A new legal structure, known as a Community Interest Company, provides a solution.

In the United Kingdom a new class of company with limited liability was developed for entities with an aim to benefit the community. The legal form has been adopted by social enterprises and charities which service the community by combining the pursuit of social purpose with commercial activities. The requirements in the UK to form a Community Interest Company are:

- Satisfy and continue to satisfy a community interest test

- Adopt certain statutory clauses in its constitution (this includes a clause to lock in the assets to providing benefit to the community)
- Deliver an annual community interest company report with its annual accounts<sup>11</sup>

To provide a balance between encouraging people to invest in Community Interest Companies and the principle that the assets and profits of a Community Interest Company should be devoted to the benefit of the community, a dividend cap may be used. Based upon the British experience the dividend cap has three components:

- The maximum dividend per share which limits the amount of dividend which can be paid on any given share in terms of a percentage of the amount paid up on that share,
- The maximum aggregate dividend which limits the total dividend declared in terms of the profits available for distribution,
- The ability to carry forward unused dividend capacity from year to year to a limited extent.

### **Recommendation 8**

That the Government legislate through the Corporations Act 2001 to allow the establishment of a Community Interest Company. Within the revised legislation that it contains sections that require:

- Social enterprises that distribute all gains, including proceeds on dissolution, to an endorsed income tax exempt charity be limited by guarantee and all other social enterprises be limited by shares.
- Compatible requirements with the Community Interest Companies incorporated in the UK
- A dividend cap

It is further recommended that all entities incorporated under state Co-operative Acts be transferred as a Community Interest Company under the Corporations Act.

It is further recommended that a subsidiary of a “Community Interest Company limited by guarantee” may have all directors appointed by the parent entity. A subsidiary entity may be a charity incorporated under other legislation. A Community Interest Company may not be a subsidiary of an entity not incorporated under the Corporations Act 2001.

It is further recommended that the Australian Securities Investment Commission continue to regulate all entities incorporated under the Corporations Act, including Community Interest Companies and not-for-profit companies limited by guarantee. It is further recommended that the public disclosures of a Community Interest Companies be determined by whether the entity is a reporting entity and its size. Size will be determined by the following criteria:

- the consolidated revenue for the financial year of the community interest company and the entities it controls (if any) is less than \$25 million
- the value of the consolidated gross assets at the end of the financial year of the company and the entity it controls (if any) is less than \$12.5 million
- the company and the entity it controls (if any) have fewer than 50 equity holders, or members.

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<sup>11</sup> *Community Interest Companies Guidance: Overview of a community interest company*, downloaded 28 August 2008 from [www.cicregulator.gov.uk](http://www.cicregulator.gov.uk).

## **Recommendation 9**

That the Government provide adequate resources to peak bodies of each charitable sector to provide support and education on good governance and management of charities<sup>12</sup>. It is intended that this recommendation supplement a regulation model that promotes specialisation where:

- Issues relating to compliance with incorporation requirements will be managed by the regulatory body for that type of legal structure. For example issues relating to all companies about obligations under the Corporations Act will be managed by the Australian Securities and Investments Commission, and all incorporated association issues under a new national Association Incorporations Act will be managed by the Department of Housing, Community Services and Indigenous Affairs.
- Issues relating to good governance and management will be worked through with assistance from a peak body with the expertise within that charitable sector and referred to specialists when required.
- Professional bodies, such as the Fundraising Institute of Australia and CPA Australia, provide advice, support and development to volunteers and professionals involved in that particular function within not-for-profit entities and social enterprises.

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<sup>12</sup> These are the non-regulatory responsibilities of the New Zealand Charities Commission as downloaded 28 August 2008 from [www.charities.govt.nz](http://www.charities.govt.nz).