SUBMISSION TO INQUIRY INTO THE DISCLOSURE REGIMES FOR CHARITIES AND OTHER NOT-FOR-PROFIT ORGANISATIONS BY THE SENATE STANDING COMMITTEE ON ECONOMICS

Submitted by Professor Mark Lyons, University of Technology, Sydney

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This submission and the terms of reference

The Senate Standing Committee on Economics has been asked to inquire into:

(a) the relevance and appropriateness of the 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 organisations and cater for emerging social enterprises; and

(c) other measures… to assist the sector to improve governance, standards of accountability and transparency in use of public and government funds.

This submission:

(a) argues that current disclosure regimes are confusing and inappropriate; and

(b) outlines a model for a single national act, regulator and public disclosure regime encompassing all not-for-profit organisations including charities and social enterprises.

(c) such legislation and its accompanying regulatory and public disclosure regime will markedly improve governance, standards of accountability and transparency in use of public and government funds by the not-for-profit sector.

However, the submission also argues that to develop the necessary legislation and other arrangements will require many months of work by a well resourced task-force.

Overview

This submission demonstrates that Australia's nonprofit organisations are entwined by a tangled web of law and regulations that inhibit their ability to maintain and enhance their vital contribution to Australia's economy, society and system of governance in this twenty-first century. It argues that Australian governments should reform and simplify this. Reform must be comprehensive. It is urgent that work begin soon, but that the process is conducted with care.

A few years ago, Australia's state and federal governments agreed to create for the for-profit or business sector a single act (corporations' law) and a single authority (ASIC) to regulate all forms of business and their fundraising. This was the

culmination of a fifty year process and was done to facilitate and encourage the growth of business. In a similar fashion and for similar reasons, Australia's nonprofit organisations should be given a single act to govern their incorporation and fundraising and a single regulator to enforce this law and its attendant regulations and to ensure appropriate levels of public transparency.

The single most important action that Australian governments could take to assist the growth and needed transformation of Australia's nonprofit organisations is to ensure that all economically and politically significant nonprofit organisations publicly report annually in a way that is appropriate, comparable and easily accessible to any member of the public.

Existing legal and regulatory arrangements are so complex and muddled that only a completely new, purpose built system will achieve the goal of a simple and appropriately designed system. Tacking nonprofits onto corporations and requiring ASIC to regulate them is certainly not appropriate. Because nonprofit organisations differ in some fundamental ways from business, the new act and regulator must be purpose built, based on a clear understanding of the behavioural dynamics of nonprofit organisations and recognise that most nonprofits are very small and rely entirely on volunteer labour.

This is the first ever inquiry by an Australian parliamentary committee or government agency that has sought to encompass the whole of the nonprofit sector. Previous inquiries such as the Industry Commissions' 1994/95 Inquiry into Charitable Organisations, or Justice Shepherd's 2001 Inquiry into the Definition of Charities and Related Organisations, focussed on only some of the range of organisations that constitute this third organised sector of the Australian economy. Had their recommendations been adopted in full they would have only added to the complexity of arrangements. Only a comprehensive focus can deliver needed simplification.

However, the level of understanding of the nonprofit sector within Australian governments is poor. Needed reforms will be extensive and will require extensive research, consultation and reflection. This submission argues that the appropriate path for this Inquiry is to recognise and develop the case for reform and to propose how the more extensive task might be pursued.

Definitions

The nonprofit sector is comprised of nonprofit or non-profit organisations. The term nonprofit is shorthand for 'private nonprofit distributing'. It is the term most commonly used in the scholarly literature and by central statistical agencies, for example, in the National Accounts. 'Private' and 'nonprofit distributing' delineate the two characteristics of this class of organisation which distinguishes them from government owned/controlled entities and from for-profit firms which distribute profits to owners. The test for private is that neither a minister nor other state actor can be held responsible for the actions of the organisation; the test to distinguish them from business is that the organisation has a clause in its constitution prohibiting the distribution of a surplus or 'profit' to members or other stakeholders. This is a more objective test than the test of purpose implied by use of 'not-for-profit', though both

terms refer to the same set of organisations. Most nonprofits also differ from for-profits in that they are democratically governed, that is each member has one vote; in for-profits, voting power is proportionate to money invested.

Charities are nonprofit organisations. However, in practice and in government policy, there is little that distinguishes them from many other nonprofit organisations. Charities are provided with tax exemption, but so are many other nonprofits; some charities are deductible gift recipients (DGRs), but others are not and many non-charities are DGRs. Some charities are subject to charitable fundraising laws, but so too are many non-charities while many charities are exempt. To focus reform efforts on charities alone would be foolish.

Dimensions and contribution

There are perhaps as many as 700 000 nonprofit organisations in Australia. But less than 40 000 of these employ staff. These organisations employ almost 900 000 people and in 2006-07 turned over almost $75 billion (ABS 2008). They are major providers of health services and social assistance, of education and training, of arts, sport and recreation services and employment services. They constitute the entirety of providers of religious services and of civic, professional and other interest group services and are important niche providers in accommodation and food services, broadcasting, scientific research and financial and insurance services (Lyons 2001). In 2000 they were estimated to contribute around 3.3% to GDP (ABS 2002).

But the nonprofit sector is far larger than these economically significant actors. These, but more importantly the 100s of 1000s of volunteer only organisations collectively institutionalise the virtues of altruism and mutuality and contribute massively to building and sustaining a strong and stable society. By encouraging political participation and by giving voice to various interests they are an essential component of a strong democracy (Passey and Lyons 2005). For these contributions they have no competitor.

Almost all Australians are part of the nonprofit sector. Almost 90% of adult Australians belong to at least one nonprofit; a similar proportion supports them with donations (Passey and Lyons 2005, Lyons and Passey 2005). Around 35% give time as volunteers (ABS 2007).

Australia's nonprofit sector makes around the same contribution to the economy as does the nonprofit sector in countries such as the United States and the United Kingdom (Salamon et al 1999). Yet it is afforded far lower recognition here than in those two countries.

The regulation of nonprofit organisations

Nonprofit organisations receive a confused and confusing treatment in law and its associated regulations.

One way of illustrating this is to look at the decisions faced by persons wishing to start or incorporate a previously unincorporated nonprofit association. In any state or territory they are faced with at least three possible ways of proceeding: as a company limited by guarantee (a form of public company), as an association or as a cooperative. If they were an aboriginal group they could look at incorporating as an aboriginal corporation. But in some states, if they were an association of government school parents they would be required to incorporate under the education act. If it was a trade union they formed, another different route to incorporation would be required. Alternatively, if they were faith-based they might avoid incorporation while apparently obtaining its advantages through their standing with their sponsoring denomination, itself incorporated by a special act of parliament.

A similar variety of laws would confront them if they wished to seek donations from the public. If they wanted to raise funds in several states they would need permission in each jurisdiction and confront different and contradictory reporting requirements. And if they wished to engage in fundraising raffles or bingo they might need permission from yet another authority. But they may be able to ignore all this if they qualified for one of the many exemptions provided by these laws.

The failure of governments to develop simple, clear and consistent policies toward nonprofit organisations is nowhere more evident than in the tax system. Australia's tax system offers many nonprofits exemptions of various types and for some, facilitation of fundraising by allowing donors to exempt their donation from their taxable income. But the rules determining which organisations get which concessions are many and confusing and are not informed by any principle or theory. For example, the ATO identifies 34 different sets of criteria by which a nonprofit organisation may qualify for tax exemption. There are 47 different sets of criteria for qualifying as a deductible gift recipient. Most of these rules are administered by the Australian Taxation Office (ATO). State and local governments also allow certain exemptions.

Another important set of nonprofits that are almost entirely free of any kind of regulatory scrutiny and are mostly entirely opaque to the public are endowed charitable trusts. As charities they pay no tax on what are in some cases sizeable investments. Whether self administered or managed by a trustee company, they are the responsibility of state attorneys general who take no interest in them. The ATO is supposed to ensure they make payouts (a minimum level is stipulated only for the newly created Private Prescribed Funds, once they become operative) and only to nonprofits entitled to receive them, but while a few report their grants none publicly reveal the size of the funds they hold nor where they are invested. This data is collected nowhere.

There seems little doubt that the regulatory quagmire that surrounds nonprofit endeavour inhibits the formation of new nonprofits. Public understanding of and confidence in the nonprofit sector is also inhibited, in this case by the limited requirements for public transparency.

To the extent to which different groups of nonprofit organisations are required to report to a regulator, two further problems emerge. Only in some cases are these reports public documents, in at least one case accessing the report requires payment of

a fee. This makes it impossible for members of the public to compare organisations before bestowing their support. It also lessens the likelihood that members of the public will alert authorities to the fraudulent use of a nonprofit, perhaps to gain access to tax concessions. But even if more data was publicly available, comparisons would be impossible because there are no accounting standards mandating ways of treating various transactions that are peculiar to nonprofits, such as charitable fundraising.

There is no point at which reports from all or even a large number of nonprofits are gathered and scrutinised. For most, a condition of incorporation is the filing of an annual return with the relevant regulator. But governments give regulators few resources and compliance is poorly monitored. Research into the regulation of associations in NSW found that more than one in five of associations that had not filed an annual return for over three years and were considered by the regulator to be defunct were still operating (Passey 2004). By default, over the past few years the ATO has become the de facto regulator of parts of the nonprofit sector. But only of parts: many nonprofits are allowed to self-assess whether they are tax exempt; almost all are exempted from filing income tax returns.

Reasons for this regulatory morass are not difficult to find. Nonprofit organisations are not acknowledged, neither by governments nor the public, as constituting a single, distinct sector in the way that businesses are acknowledged. Rather each nonprofit organisation is seen as belonging to a relatively small group of peculiar organisations (peculiar because they are not government and not business) - eg private schools, churches, unions, charities, sporting clubs, registered clubs, lobby groups, environment groups, NGOs and so on. None of those terms are closely defined and often overlapping. So, at different times laws are made for one group or another without any regard for the whole. Such an approach may have been justifiable in the nineteenth and early twentieth century; it is not now.

This continuing piecemeal treatment of nonprofit organisations cannot be because they are too diverse to be encompassed by a single law and regulator. The for-profit sector is so encompassed and yet it contains an even greater variety of organisations that differ one from another in size and in the range of activities they pursue.

The failure to recognise that nonprofit organisations constitute a sector is both source of the regulatory problem but works to reinforce the problem. In this way is created a vicious circle.

Why is it important to encourage nonprofits?

Some argue that there are only two organised sectors of an economy, business and government. In a market economy, businesses are the most appropriate form of organising, governments' role is to ensure the correct operation of the market and when markets fail to provide service themselves. In this world, there is no place for a nonprofit sector. But this is to misunderstand the place of markets in society. Nonprofit organisations have be seen as a response to market and to government failure (eg Weisbrod 1988, Hansmann 1996), but others argue that a rich associational life underpins a successful economy (de Tocqueville 1966, Putnam 1993). Salamon (1987) suggests that the welfare state was a response to nonprofit failure. Nonprofit

organisations are also an important source of social innovation. In Australia for example they created aged persons housing. Social entrepreneurs generally choose the nonprofit form as the most appropriate way of providing a public service, or a service to a group of similar people (Young 1983).

Let us review the reasons people form nonprofit organisations. Sometimes it is to provide services that will help others. Here the nonprofit form is chosen as a signal of their altruistic intent. Sometimes people work together to generate services for themselves, as when a group of people form a credit union because of dissatisfaction with the services provided by banks. Sometimes a group of people form an association to pursue an enthusiasm (eg tennis, fishing, photography) and attract others to join their association. Sometimes people join together to argue for a cause in which they have a collective interest or believe will benefit the wider public. These are mutual endeavours and the nonprofit form indicates their commitment to collective rather than individual benefit. Both the altruistic and the mutual impetus are as important now as they have ever been. Good public policy would seek their facilitation and not allow them to be inhibited by messy, incoherent laws.

Existing nonprofits, many of which are over a hundred years old, also held back by the existing regimes. Current law applies the same standards of governance to volunteer directors that apply to well-paid directors of public companies that are many times the size of most nonprofits. Many skilled professionals that are needed as directors of larger nonprofits fear the personal financial risk of joining such boards and many law and accounting partnerships prohibit partners from becoming nonprofit directors (because of the risk to other partners. Only a properly developed nonprofits act can spell out an appropriate set of expectations for directors.

Existing nonprofits also need to be able to review what they are doing and to make necessary changes. They need a legal environment that not only facilitates (rather than inhibits) such changes (such as creating a national body from various state entities), but many also need the spur to do so that operating in a fully transparent environment will provide.

Nonprofit organisations institutionalise two virtues that have been central to the evolution of helping others (altruism) and collective self-help (or mutuality). It is sensible public policy to encourage these virtues by encouraging their institutional form.

Why are current arrangements a problem?

The current confusing array of laws and regulations entwining nonprofit organisations has a number of deleterious consequences, for governments, for the public and for nonprofit organisations.

For governments:

- In the absence of a single regulator, governments lack data and knowledge of Australia's nonprofit organisations and are therefore unable to develop

appropriate policies to better regulate them and encourage their formation; it is also unable to recognise when parts of the sector will be negatively, though unintentionally affected by other legislation;

- In the absence of a purpose built register populated with appropriate and regularly updated reports from all economically significant nonprofits, government departments seeking to contract or in other ways work with nonprofits are forced to collect a great deal of information themselves, generating higher than necessary program management costs;
- The absence of a single comprehensive and competent regulator encourages greater use concessions available to nonprofit organisations for personal enrichment or to use these organisations for money laundering or to hide other criminal activities than would otherwise be the case;
- In a similar way the absence of a single register reduces the likelihood that the public will inform authorities of possible instances of abuse.

For the public (and firms and foundations)

The absence of a single nonprofit regulator containing details of all economically significant nonprofits

- Reinforces the low level of public understanding of the sector and reduces to movement to informed giving;
- Makes it almost impossible to obtain information of a comparative kind, to allow donors or grant makers to make informed choices about their giving;
- Makes it impossible to discover who the backers of think tanks/advocacy orgs are or to test claims by advocacy organisations about their representativeness.

In addition, the absence of a data set that would also include reports from for-profit enterprises that engage in fundraising on behalf of certain nonprofits

- Increases the risk that members of the public will be misled, either deliberately (eg celebrity dinners that return 5% to charity), or inadvertently.

For nonprofit organisations:

The current piecemeal and confusing regulatory regime is most strongly felt by nonprofit organisations.

- Because current fundraising laws and most forms of incorporation are state or territory based it increases the cost on national organisations and inhibits the merging of state based entities into single national bodies.
- Because existing regulations are not designed for nonprofit organisations and do not provide the data needed to assess the performance of organisations they are of no value to government funders who must in turn demand otherwise unnecessary but burdensome reporting;
- The web of poorly designed and badly explained laws mean that directors of nonprofit risk noncompliance with laws because of ignorance;
- The absence of a single law and regulator ensures that the nonprofit sector will continue to lack public recognition;

- The absence of single competent regulator and its attendant low public understanding, generates in financial institutions a higher than necessary concern with risk that in turn inhibits lenders and thus the availability and cost of capital (Lyons, North-Samardzic and Young 2007)
- In a similar way, uncertainty about risk reduces numbers of people prepared to join boards while ignorance of nonprofit entities reduces effectiveness of governance generally.
- The absence of a single source of readily available and comparable information from larger nonprofit organisations reduces public trust in these organisations along with the size of public donations.
- Lack of transparency ensures that most charitable trusts are run as exclusive clubs to the detriment of the public interest

Australia's nonprofit sector has played a vital role in the development of many of the social institutions that Australians rely on for services, recreation and identity. But the sector is changing. Parts of the sector, such as trade unions and service clubs have declined in numbers of organisations and membership while in other fields, such as health or the environment, new nonprofits have formed to address old and new illnesses and new problems. Once important nonprofits such as cooperative building societies have merged and been converted to banks but new nonprofit enterprises are being formed by social entrepreneurs. Overall Australia's nonprofit sector is keeping pace with the growing economy, but not much more than that. Anecdotes suggest that red tape, lack of understanding and risk are causing some to fail that would not otherwise and leading some exciting initiatives to expire prematurely or to choose a less appropriate for-profit form.

In Australia, little is asked of the nonprofit sector. By contrast, in many European countries and in North America governments seek to encourage the growth of nonprofit initiatives (Lyons and Passey 2006, Delors 2004). For Australia to embrace the practice of like countries will require a root and branch transformation of law and regulations that affect the sector.

Some say that the 21st century will be the century for nonprofit organisations in the way that the 19th and 20th centuries were the era of the investor owned firm. This may be so, but it will not be in Australia, unless there is a serious attempt by governments to create an encouraging environment.

What is to be done?

The confusing and chaotic legal and regulatory arrangements confronting nonprofit organisations have two distinct dimensions. One is generated by the plethora of laws and regulations and exemptions covering incorporation and fundraising. The other is found in the tax treatment of these organisations. Reforming both these areas should not be attempted at the same time

Before addressing the tax treatment of nonprofit organisations, the confusing arrangements for incorporation and nonprofit forms of fundraising should be simplified. This should be done by creating a single national nonprofits act and regulator to replace current multitude of laws and regulations. Effective reform here

can free up the sector and reduce government management costs. It can ensure that full, appropriate and comparable data is available publicly on all but the smallest nonprofits. Good data and a far better understanding of the way nonprofits contribute to the public good and the extent of that contribution is a prerequisite for the challenging task of reviewing nonprofit tax concessions.

What is needed?

The first step is to be clear about the **goals** that a national law and regulatory regime for nonprofit organisations is trying to advance. These should be:

- To encourage the formation of and effective operation of nonprofit forms of organising.
- To ensure transparency of these organisations to the public (inter alia as a way of improving understanding and appreciation of this form of organising).
- To give a clear guide to governors of these organisations as to their duties and responsibilities
- To clearly identify risks to the public interest and ensure that regulations address these in a way that recognises the size of the risk and so applies the minimum reporting requirements commensurate with that risk
- To ensure that law and regulations are framed with an understanding of the unique behavioural characteristics of nonprofit organisations and are informed by the latest understandings of effective regulation and appropriately balance incentives for good behaviour with punishments for transgressions.

To achieve these goals, three **institutional developments** are required.

1. A single, national act and regulator covering nonprofits. The act should:
   a) Be based on current knowledge of the behaviour of nonprofits and of the risks attendant to that form.
   b) Draw on the latest developments in regulatory theory.
   c) Recognise that there are several different broad classes of nonprofit, each requiring different levels of disclosure.
   d) Establish reporting requirements that reflect both the needs of regulators to ensure the viability of organisations and to prevent abuse but also answer questions which members of the public (and organisational members) are most interested in. Reports will combine financial with non-financial data and short narrative reports.
2. There is a set of accounting standards that ensure reports submitted by nonprofits (whether audited or not) are comparable.
3. There is an independent searchable website on which reports are available and accessible without cost.

Elaboration

1. A single act and regulator

The Commonwealth government already has power over trading corporations. It would appear that this power captures all economically significant nonprofit organisations, but there is still uncertainty about how far this definition extends, so for the cleanest solution, the states should refer powers over all non-trading associations to the Commonwealth. It is difficult to see why they would want to hold onto these powers as they gain little income from registration fees and attend to them but perfunctorily. Nonetheless referral would produce small net savings to state budgets.

States should also transfer to the Commonwealth all power to regulate charitable fundraising. Again, this would not entail the loss of a significant power.

The question of whether states should transfer power over fundraising by forms of gambling may be contested, as nonprofit fundraising by the conduct of games of chance, such as bingo and art unions is part of state government regulation of larger gambling enterprises such as poker machines and bookmaking. Taxing as well as regulating these latter forms of gambling is an important revenue source for the sates. However, most states legislatively distinguish between machine gambling and lotteries and the like, so transfer of these powers to a single national regulator could be readily done (and make it easier for nonprofits to conduct such appeals nationally). If responsibility for any of these forms of fundraising by nonprofit organisations is to remain with the states the national regulations should require full reporting of revenue and expenses from these forms of revenue making by nonprofits that engage in them.

The regulator should stand alone. It should not become simply an extension of the ASIC. The ASIC is clearly having difficulties managing its existing regulatory responsibilities. Its systems and its organisational culture are formed by its interaction with for-profit corporations. Nonprofit organisations are very different and require a very different regulatory approach.

1a) Based on knowledge of nonprofit behaviour

There is a growing body of research about the behaviour of nonprofit organisations. It emphasises that in important ways their behaviour is different to the for-profit firm (eg Rose Ackerman 1986, Salamon 1987, Weisbrod 1988, Hansmann 1996, Borzaga and Defourny 2001, Anheier and Ben-Ner 2003, Dollery and Wallis 2003, Steinberg 2006). The motives of those directing and managing nonprofits are different to those responsible for for-profit ventures; judgements about nonprofit performance require different metrics to those required to judge for-profit performance and nonprofits can fail for different reasons. While public trust can still be abused by self-interested use of the nonprofit form, nonprofits are generally more trustworthy, but more prone to amateurism and factionalism. Legislation and regulation needs to be informed by these understandings if it is to encourage the strengths of this form of organising.

1b) Draws on the new theories of regulation

Over the past twenty years a growing body of research into the operation of regulation has developed a body of theory known loosely as the new regulatory theory. At its most basic, this theory argues that to shape the behaviour of regulated entities requires

an understanding of their behavioural dynamics, a carefully calibrated set of incentives as well as penalties and a willingness to work cooperatively to help nonprofits that experience problems with regulatory compliance (eg Braithwaite 1999, Campbell and Picciotto 2002). Law and regulations should link this thinking with what is known theoretically and empirically about the behaviour of nonprofit organisations.

1c) Provides for different levels of disclosure.

Although simplicity requires a single act and regulator, variations in size and the extent and breadth of interactions with the public suggest the creation of several different classes of nonprofits for regulatory purposes. The logic is the same as that applying in corporations' law which recognises five different types of entity requiring different levels of regulation, reporting and scrutiny.

The first step is to remove the great majority of nonprofit organisations from all regulatory oversight. The great majority of nonprofit organisations are very small, relying entirely on the volunteer effort of members. Around half of the estimated 700 000 nonprofits are not incorporated and many of those that are incorporated are very small. In a random sample of incorporated associations in NSW Passey found that 35% had annual incomes less than $10 000; another 46% had incomes between $10 000 and $100 000 (Passey 2004). This suggests that over 90% of the estimated 700 000 nonprofit organisations have incomes of less than $100 000.

Leaving aside for the moment the question of where precisely an appropriate cut off point might be, a national nonprofits act should follow the example of many American states and exempt small nonprofit associations from any form of incorporation while providing their members with the basic protections provided by incorporation. In the absence of an equivalent to Australian incorporated associations' legislation these states have adopted model legislation that overrides the way the common law applies to unincorporated associations so as to allow them to hold property, to sue and be sued as an entity and to protect individual members from wrongs done by the association. This protection is automatic and requires no registration by the association (Hopkins 1992). Such legislative provision would provide protection to members of many small unincorporated associations while allowing many small incorporated associations to allow their incorporation to lapse with out loosing the basic protections which it bestows. It would reduce an unnecessary regulatory burden on both government and groups of people who have organised as small nonprofit associations. The regulator could provide a range of web based materials to help people form and successfully operate small associations.

Larger nonprofits, those with at least one employee or that receive government grants/contracts or that raise more than $5000 from the public, or that possess capital of at least $100 000 (eg an endowed charitable trust), if they wished to receive the benefits of incorporation, should be required to incorporate and to report annually to the nonprofits regulator. Nonprofits with one or more of these characteristics are likely to have an impact beyond their membership. Trying to ensure their continuing viability and to assure the public of this via disclosure and regulatory scrutiny should be an object of public policy. There may be a case for requiring different levels of

disclosure, depending on size or level of commercial or trading activity. This is discussed below.

1d) What should be disclosed?

The main regulatory instruments would be a requirement that incorporated organisations follow certain rules (such as non-distribution of profits, a clearly stated mission and commitment that resources are devoted only to that mission) and file an annual report in a timely fashion with the regulator. It should not be necessary to require reports from smaller incorporated nonprofit organisations to be independently audited, but once a certain size of turnover or capital is reached it becomes important to have an independent review (which larger organisations can afford). These reports should contain the usual financial statements, but presented in a way that reflects the interests of stakeholders in this class of organisation (current reporting practices followed by most large nonprofits are designed for public companies and do not readily provide information that say a donor would be interested in). For example, they should identify sources of fundraising revenue (eg budget campaigns, capital campaigns, merchandising, bequests, gaming) along with their costs. They should also indicate numbers of members, revenue from members (as fees, gifts and trading income) along with costs incurred in providing member services. Where appropriate they should also report numbers of volunteers and estimates of the value of their contribution (this will require the regulator to issues a regularly updated formula for converting different forms of volunteer work into monetary value). Financial reports should also indicate sources of any long-term debt and the characteristics and returns from investments. These are only indications of the sort of information that stakeholders in nonprofit organisations and other interested parties might be interested in. A good deal of research and consultation would be required to develop an appropriate reporting form.

By definition, nonprofit organisations cannot be assessed by the usual metrics applied to for-profits, most of which include profit as a numerator or denominator. The performance of nonprofits cannot be as easily assessed. Interesting work on assessing returns on social investment is being done by the New Economics Foundation in the United Kingdom and Social Ventures Australia but this is work in progress and applies only to social service and social development nonprofits. Overall, the best approach is to focus on the organisations mission or objectives and on publicising its own methods of mission achievement and their results. It is worth noting that the English Charities Commission now requires some reporting in narrative form. Member serving organisations that engage in advocacy should be required to report on how their members shaped policies espoused in the previous year; other advocacy organisations and so called think tanks should be required to identify all donations over $1000, so that members of the public can assess whether their espoused policies might reflect the interests of particular donors. Charitable trusts that are over a certain size limit should also be subject to these disclosure rules. The regulating authority may deem it prudent to develop rules for investment of trust funds or endowments.

Development of an appropriate reporting format will require a good deal of discussion between various stakeholders. Its application will require a good deal of continuing education of the accounting profession.

Remarks above suggested that nonprofits deemed significant enough to require incorporation and annual disclosure might be divided into those required to submit audited reports and those that are not. It should be noted that for the most part audited reports of nonprofit organisations indicate that they were unable to verify all aspects of the nonprofits transactions, as to do so would be far more expensive than would be warranted. On the other hand many nonprofits rely on the annual audit to ensure that their accounting procedures which are often conducted by book keepers are working satisfactorily. The role of auditors in the preparation of annual reports is one that requires further consideration.

The discussion above assumes that organisations are nonprofits in that they have in their constitution a clause prohibiting the distribution of any annual surplus or profit. They may also have a further clause prohibiting the distribution of net assets to members on winding up. This is required if the organisation is tax exempt, but not otherwise. However, a growing interest in what are called social enterprise raises the possibility of a certain class of nonprofit being permitted to issue a special class of equity and to pay a dividend, drawn from and based on profit. New English legislation recently established what are known as "community interest companies", which under some circumstances can raise equity capital and issue capped dividends to investors. The purpose of this legislation is to encourage the growth of social enterprises, or private initiatives that use business practices to pursue a public good. In some respects such initiatives are not new. Trading cooperatives have done this for over a century, but for member benefit rather than a public benefit. Most cooperatives are nonprofit but the minority of trading cooperatives are able to distribute a portion of profit to members in the form of a dividend, with the quantum based on the use made of the cooperative over the previous year rather than funds invested. In order to allow trading cooperatives to raise more capital, in the 1990s the New South Wales government legislated to permit them to issue cooperative capital units (CCUs) which may be structured as debt or as a form of equity tradable on the ASX. As with the UK Community Interest Companies, the CCU if structured as equity bestows only limited rights on investors. There appears to be a case for making such opportunities for quasi-equity fundraising available for what remain essentially nonprofit organisations. A further class of nonprofit entity should be created for nonprofits that wish to take advantage of this opportunity. The regulator would be required to develop rules for the issuing of these instruments. Further disclosure rules may also be required.

Another section of the nonprofits act should create a disclosure requirement for government controlled entities that raise funds from the public. These include government schools, government hospitals, public universities, art galleries and museums. It has been estimated that around 8% of funds donated by the public are to government controlled entities. This amounted to almost half a billion dollars in 2004 (Lyons and Passey 2005). Additional funds would have been donated by business. In the interests of fairness and full public disclosure these government entities should be required to report on funds raised in the same way as private nonprofits and also the allocation of these funds. Bearing in mind scandals associated with the application by state government health authorities of donated funds to hospital operating revenue (eg Say 2004), an alternative approach might be to outlaw all fundraising by government controlled entities. Many government bodies already have independent charitable foundations or friends or parent organisations that inter alia raise funds for allocation

to their associated entity. Provided these met a test of independence, they could be the body that engages in fundraising on behalf of the government entity. They would already be subject to the regulatory regime of the proposed nonprofits act.

Finally, the new nonprofits act should continue the practice of most state fundraising acts and regulate fundraising conducted by for-profit firms on behalf of nonprofits. Any firm that engages in fundraising should be required to register and to report. Only firms that are so registered should be permitted to engage in fundraising activity, Firms that only advise nonprofits on fundraising should not be required to register, though their engagement and payments made to them would be part of the report of nonprofits that they worked with.

2. Accounting standards

One of the most common complaints from nonprofit organisations and members of the public is that the accounting standards used by business do not apply or do not apply unambiguously to nonprofit organisations. This is because standards do not apply to many of the transactions, such as fundraising, that are central to what makes nonprofits different to business and which are an item of particular interest to members of the public. The various accounting standards bodies in Australia have worked on this task from time to time over the past fifteen years without ever bringing their work to conclusion. Clearly the accounting profession must be involved in this process, but some other mechanism, such as a government mandated and funded task force must be found to involve other stakeholders and to ensure the work is concluded. The UK approach, whereby sector neutral financial reporting standards are supplemented by a Statement of Recommended Practice (SORP) for transactions unique to a particular class of organisation, has merit (Cordery and Baskerville 2007).

3 Ensuring comparable public disclosure.

Full public disclosure of reports from incorporated nonprofits is an essential feature of an adequate disclosure regime. The use of electronic filing for reports and the ability of computer based technologies to conduct initial checks on these reports and then to make them publicly and freely available in ways that encourage search and comparison provide the main benefits that will flow from a new start for nonprofit regulation.

The US and UK Guidestar organisations provide examples of the benefits that can be obtained from use of computerised data bases hooked to powerful search engines. As well as enabling any member of the public to obtain the latest reports on any particular nonprofit, they enable them to identify and scrutinise all nonprofits providing certain services in a particular town or region. This is a considerable help in encouraging informed and rational giving (putting social investing on par with commercial investing). Even more detailed searching for analysis of the kind undertaken by fundraising consultants or governments can be undertaken for a fee.

Guidestar US obtains a regularly updated data transfer from the Internal Revenue Service (unlike Australia, the Form 990 reports filed each year by over a million nonprofits are public documents). In the UK, Guidestar receives its basic feed from the Charity Commission for England and Wales (soon to be joined by data from the Scottish Charity Commission). Negotiations are underway for Guidestar to receive information on non-charitable nonprofits such as social enterprises. To the reports filed with the charity commission, Guidestar adds data scanned from annual reports and then processes all this data into a common reporting format consisting of both financial and other numeric data and narrative.

Both the US and UK Guidestars are independent charitable organisations that work closely with relevant authorities. A great deal of work has had to undertaken to convert data sets designed for older regulatory models into usable formats and work is still underway to widen the coverage beyond charities. Because Australia lacks an existing nonprofit data set, it has the opportunity to develop a state of the art arrangement from scratch. This will take time and will be dependent on the passage of a new national nonprofit act and regulator, but it can build on the Guidestar experience. Incidentally, Guidestar international is working with Canada, Ireland and Germany to develop Guidestar websites in those countries.

One issue to be addressed will be whether to make the regulator the source of publicly available data, or to follow the Guidestar example and create an independent nonprofit organisation to manage the interface between data submitted to the regulator and the wider public.

What existing laws should this new act and regulator replace?

Ideally the new nonprofits act will replace all existing laws that regulate nonprofit organisations and their fundraising. As a minimum it should replace all existing forms of general incorporation (corporations' law as it applies to companies limited by guarantee, associations' law, aboriginal corporations' law, cooperatives law, industrial registrars etc). A few nonprofits are incorporated by their own legislation (eg some Christian denominations and 19th century charities) or even more antique forms such as letters patent that creates the Red Cross. These too should be also repealed, but if there was a good case for leaving some of this legislation in place it should be amended to bring the entities incorporated in this way under the disclosure regime of the new national nonprofits act.

The one exception to reporting requirements could be the core parts of the major denominations which provide worship and determine the rules for their congregations. These would mainly be the dioceses or their equivalent and constituent parishes of the Catholic and Anglican churches. All other works of these denominations, including their schools or school systems, welfare works and development funds should come under the new nonprofits act. It should be noted that other denominations such as the rapidly growing Pentecostalist churches and non-Christian religions already operate and publicly report as companies limited by guarantee or as associations.

Another set of nonprofit organisations that might be exempted from operating under this regime are bodies corporate which are incorporated under state and territory strata

title legislation. As mutuals they are nonprofit organisations, but they are such a specialised class and of interest only to their members (and their suppliers) that little public benefit is served by bringing them under the proposed new regulatory regime.

A third group of mutuals that might be reviewed for exemption from the new nonprofits act are the few remaining health insurance mutuals. A case can perhaps be made for excluding all nonprofit finance and insurance providers: credit unions, cooperative building societies and industry superannuation funds. It might be said that they are well regulated by both ASIC and the Australian Prudential Regulation Authority (APRA). On the other hand, forcing them to incorporate as public companies denies their nonprofit character. They should still be subject to prudential regulation by APRA, but incorporated and publically report under the new nonprofits act.

Further, the new national nonprofits act should replace all existing charitable fundraising laws. It should also replace laws governing charitable gaming, but not machine gaming.

A fall back position

The proposal outlined above will entail a great deal of cooperation between all states, territories and the Commonwealth government. Australia's past record of Commonwealth/state cooperation and referral of powers does not inspire confidence that such a task is possible.

An alternative way of approaching the task of providing much needed reform to the nonprofit sector would be for the Commonwealth to act alone. The Commonwealth government could use its powers over trading corporations to construct a single national act and regulator along the lines outlined above (though without the proposed treatment of small incorporated and unincorporated associations). It could require the transfer of companies limited by guarantee and those incorporated under the aboriginal corporations act. It could also require that all nonprofit organisations that wished to receive commonwealth funding be incorporated under the new act. It could require that endowed charitable trusts, at least those above a certain size, that wished to receive tax concessions also be required to incorporate (if the trustees were not already incorporated, as is often the case) or at least to report according to national disclosure guidelines (which would then become publically available).

The new act would cover the different forms of nonprofit fundraising as discussed above. Corporations' law covers fundraising by corporations; in a similar way, the nonprofits act would cover various forms of fundraising by nonprofits. Nonprofits that chose to incorporate thus would be able to conduct fundraising appeals nationally without the difficulties of obtaining registration in each state. In a similar way, incorporation under national legislation removes the requirement (often overlooked, it must be said) that state incorporated entities such as associations and cooperatives should register as a foreign corporation if they conduct activities in another state.

The Commonwealth should facilitate migration to the new system by exempting nonprofit organisations that wished to migrate from any costs associated with the move, such as capital gains tax or stamp duty (with the agreement of the states).

The outcome of this approach would be that there would be modern, purpose built Commonwealth legislation co-existing with the current array of state legislation. It is likely that many or most economically significant nonprofits would migrate to the new system. It is likely that most associations of a significant size would choose to migrate. It would be a way of demonstrating that they were well governed; it would provide clearer guidelines for their directors and through the information portal they readily would obtain a national profile.

Over time it might render redundant the various pieces of state and territory legislation. It would not provide the advantages to unincorporated associations and to small incorporated associations that find the responsibilities of incorporation burdensome that adopting a US model unincorporated associations legislation would achieve. But that would remain an approach that individual states should consider.

A second fall back position

Should the Committee believe that even this modified proposal for a national nonprofits law is beyond the capability of the Australian government, it might focus attention on ensuring that economically significant nonprofit organisations are subject to a common and public reporting format. Accessing tax concessions could be made dependent on economically significant organisations following this format. This would mean a focus on 1d, 2 and 3 in the **Elaboration** section above. This would leave in place amended versions of the many regulatory regimes created by various laws of incorporation and fundraising, but would require each to be amended to apply a common reporting format. That format would utilise common accounting standards and all reports would be made available on a publicly accessible and searchable website. Such an approach would not have the all the benefits of the main approach outlined above: it would not facilitate the formation of new nonprofits nor the transformation of existing ones, but it would open the nonprofit sector to public scrutiny (thus increasing regulatory effectiveness), increase public awareness and understanding of nonprofit organisations, and could reduce government program management and thus nonprofit compliance costs.

Conclusion

This submission has argued that:

- Current regulatory arrangements encompassing nonprofit organisations are a dreadful mess, that they are costly to governments and nonprofit organisations and disadvantage the public;
- Establishing a clear, simple and transparent system of regulation and disclosure encompassing all nonprofit organisations is a matter of highest priority;

- All existing laws providing for the incorporation of nonprofit organisations and regulating their fundraising should be replaced by a new national act and regulator.
- Any efforts to reform the way nonprofits are treated in the taxation system should be deferred until a simple and appropriate regime for incorporation and fundraising has been established;
- Playing with incremental reforms to parts of the existing confusing system will only add to the confusion;

It concluded by outlining some of the key features that a reformed and simplified regime should have.

The submission seeks the Senate Committee's agreement with the broad thrust of this approach, but also its acknowledgement that the task will be a challenging one given the limited understanding of nonprofit organisations within government and the public generally.

For that reason it is submitted that the next step should be for the Commonwealth government, with agreement of state and territory governments, to establish a high level task force, equipped with a significant research capacity to develop detailed proposals along the lines outlined. Such a task, if done properly, would take at least 18 months.

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