



29 August 2008

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

Dear Mr Hawkins,

**Senate Inquiry into Disclosure Regimes for
Charities and Not-for-Profit Organisations**

Associations Forum Pty Ltd is a privately owned for-profit entity that provides services to associations and charities. Our mission is "bringing associations together to boost performance". Over 300 not-for-profit organisations subscribe annually to our education and information services, and hundreds more organisations participate in these events or are involved in other projects. We are in close touch with the not-for-profit sector in Australia.

Our management team has prepared this submission based on practical observations of the not-for-profit sector and with input from some of our valued colleagues.

Associations Forum notes that the not-for-profit sector is effective and not in a state of crisis. However, there are clear improvements that can be made to the sector's regulatory framework across Australia. The present muddled system needs to change, and it will result in a better mutually owned, cause driven part of the Australian community and economy.

We congratulate the Senate for its investigations into the sector through this Inquiry.

Yours sincerely,

John Peacock
General Manager

Associations Forum Pty Ltd PO Box 810 Artarmon NSW 1570
Ph: 02 9904 8200 Fax: 02 9411 8585 www.associations.net.au

Submission to Senate Inquiry into Disclosure Regimes for Charities and Not-for-Profit Organisations

Terms of Reference

“On 18 June 2008, the Senate referred the Disclosure regimes for Charities and not for profit organisations to the Senate Standing Committee on Economics for report by the last sitting day of November 2008. The inquiry will examine:

- 1 the relevance and appropriateness of current disclosure regimes for charities and all other not for profit organisations;
- 2 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
- 3 other measures that can be taken by government and the not for profit sector to assist the sector to improve governance, standards, accountability and transparency in its use of public and government funds.

The closing date for submissions is Friday 29 August 2008.”

1. Scope & style of input from Associations Forum

- 1.1. Associations Forum Pty Ltd's submission is broad. We have not looked in detail at matters such as donor perception, fundraising income and administrative expenses as there will be other submissions by parties with more expertise in these areas. We have instead looked at some importance governance issues, such as the importance of voting membership in a mutual ownership structure.
- 1.2. Associations Forum believes we have addressed the questions in the Background Paper in this submission, although not in that question by question style.

2. Different "ownership" leads to different scrutiny of finances

- 2.1. Associations Forum believes it is better to describe entities operating in the Australian economy as having "three forms of ownership", rather than the economy having "three sectors".
- 2.2. The first form of ownership, **commercial businesses**, allows people to invest funds as they choose, and for such businesses to operate relatively privately, with the exception of publicly listed companies. Public scrutiny of the finances of private businesses is generally inappropriate.
- 2.3. The second form of ownership, **government**, is ownership by governments on behalf of the people of the nation or a particular state. Public scrutiny of the finances of government is generally appropriate.
- 2.4. The third form of ownership is **mutuality**, which is a concept different to ownership, and it applies to associations, charities, credit unions, unions, political parties, industrially registered industry associations and clubs that exist for a cause, and not just for profit.
- 2.5. Public scrutiny of the finances of not for profit mutuals is generally appropriate as there are more stakeholders with a valid interest in their operations, and tax advantages are received.
- 2.6. The word "mutual" seems out of common usage, but we find it an apt description. "Ownership" is not as appropriate because ownership implies an interest that can be bought and sold, which is not the case for not for profits.

2.7. As general rules:

- the fewer voting members, or
 - the greater amount of government or public income
- the greater the need for scrutiny.

3. **Good governance principles**

3.1. In its submission to the Treasury's June 2007 Discussion Paper on Financial Reporting by Unlisted Public Companies, **Chartered Secretaries Australia**, the membership association for governance professionals, says "the essence of good governance is accountability, transparency and stewardship, and any reform of the financial reporting framework for public unlisted companies must balance the reasonableness of compliance requirements, particularly for smaller companies, with the need to ensure that stakeholders continue to have confidence in the governance of such companies."

3.2. Associations Forum concurs and adds that volunteer and staff leadership of not for profit organisations are given stewardship of the entity and responsibility for funds of an organisation that will usually last beyond the initiative of its founders.

4. **Terminology is misleading: profits are necessary**

4.1. The term "not for profit organisation" does not well describe these organisations and should be changed because it is misleading as profits are necessary. We suggest "Cause Driven Organisation" (CDO) as an alternative name, as each such organisation has a cause, mission or purpose that inspired its formation and drives its continued existence.

4.2. "Company Limited by Guarantee" is not ideal terminology nor is it well understood. In Companies Limited by Guarantee, members guarantee to pay a sum in the event of the winding up. However, there is no guarantee that suppliers would receive monies owed to them in the case of insolvency. A better term for this type of company may be "Mutual Company", as it is all about members who do not have shares that can be bought and sold.

4.3. Associations Forum does not think the use of the word “social” in any new broad overarching term (eg community social welfare organisation; social venture, social capital) is appropriate as it excludes some professional, art, sporting, religious or special interest bodies.

4.4. Further, “social” is also used to describe internet groups such as Facebook (“social media”) and a day at Flemington or Randwick Races, hence it is too ambiguous for wide adoption by the not for profit sector.

5. Voting members ensure accountability of not-for-profit organisations

5.1. Having members with the ability to vote at Annual and any other General Meeting of not for profit organisations is similar to the way shareholders ensure accountability of listed companies at General Meetings. General Meetings work best when the principles of democracy and majority vote apply.

5.2. Whilst the role of a voting member at a General Meeting is limited, they should have the power to decide who the Directors are through the organisation’s constitution. The Directors of a not for profit are empowered to govern the body, and they should clearly understand that they are accountable to the voting membership.

5.3. Not for profit organisations that have constitutions that do not allow voting members to decide on who the Directors are should be flagged for possible investigation by a regulatory body.

6. Definition of a not-for-profit organisation

6.1. Not for profit organisations and charities have different definitions in different jurisdictions and legislation. We commend the definition of not for profit organisations as developed by **CPA Australia** as a good definition:

“An entity shall be classified as not for profit when:

- a. that entity has operating purposes other than to provide goods and services at a profit
- b. no member/owner has the right to surpluses of the entity
- c. that entity does not have the right to transfer ownership to members/owners, and
- d. that entity does not have:
 - I. the objective of generating profit outlined in the entity’s legislation, associated regulation or constitution, or other founding document; or
 - II. as its principal objective the generation of profit.”

7. Can the not-for-profit sector self-regulate?

- 7.1. The not for profit sector is at an early stage of its efforts to group together for common purpose. The **National Roundtable of Nonprofit Organisations**, the peak organisation of peak not for profit organisations, is only a few years old and has no full time staff yet, so will have greater input in years ahead as it develops its effectiveness through greater resources.
- 7.2. One of the special features of the not for profit sector is its capacity for self regulation, which has worked well in many professional and industry associations. Self regulation can be democratic, effective and economical. Greater effort by the not for profit mutual sector to self regulate would be an excellent way forward, backed by government encouragement and minimal assistance and expenditure.
- 7.3. Having the leaders of the not for profit sector develop an improved system, should sufficient funds be allocated for this project by the government, may aid its acceptance within the sector.
- 7.4. Examples of self regulation include the **Australian Council for International Development (ACFID)** Code of Conduct and **Fundraising Institute Australia (FIA)**, which has excellent codes of self regulation of professional fundraisers.

7.5. This Inquiry has already boosted the development of leadership by and co operation between the sector for its own component sections. It is possible that self regulation could be considered as a stage towards greater transparency for the sector.

8. Associations (as distinct from charities) are not burdened by regulations

8.1. The implications of changes aimed at certain parts of the not for profit sector (eg charities) should not unnecessarily adversely impact other parts of the sector (eg associations) that require less scrutiny.

8.2. Associations make income primarily from membership subscriptions, the provision of services such as education, and sponsorship. Any sales are commercial transactions, and commercial businesses are not precluded from offering similar services for sale.

8.3. Associations, as distinct from charities, have few special disclosure provisions and do not have onerous compliance requirements because they do not receive public or government funds.

8.4. However, not for profit organisations that receive funds from public or philanthropic donations and governments should meet appropriate and stronger disclosure requirements because of the benefits of these services are not directly received by the donors or grant givers.

9. Different disclosure levels are required for different scale of operations

9.1. It is important for differential reporting requirements to be in place so that organisations with smaller financial turnover or assets are not required to spend money on requirements designed for organisations with greater finances.

9.2. As entities are required to register for GST at certain thresholds, any resulting legislation or codes could be linked to these thresholds.

10. Tax exemptions lead to responsibility to disclose

10.1. Not for profit organisations, and charities in particular, have taxation advantages that are the equivalent of a government donation. If these organisations were commercial businesses, they would pay 30% income tax on the first dollar of profit plus other taxation depending on circumstances.

- 10.2. Further, there are strong financial advantages to Public Benevolent Institutions such as salary packaging arrangements for employees and GST advantages.
- 10.3. This contribution would total to a huge sum of money, perhaps hundreds of millions of dollars. However those organisations that gain this advantage have no requirement to disclose their estimate of the quantum of advantages they receive.
- 10.4. Taxation returns are not usually completed by Australian not for profit organisations, so little data is gained from this source.
- 10.5. Consideration should be given to requiring not for profit organisations with sizeable operations to estimate and report on the quantum of tax advantages they receive through tax advantages.
- 10.6. Not for profit organisations in the United States have clearer reporting requirements. The US Tax Code requires not for profits to complete a “Form 990” tax return each year.
- 10.7. A different document, a Form 990T, is required for disclosure of income derived from activities not core to the mission of a not for profit. Different taxation conditions apply to such non core income.
- 10.8. We note that USA charities have the differentiation of public or community benefit, similar to the Australian distinction between Public Benevolent Institutions and other charities.

11. An Accounting Standard for the not-for-profit sector is needed

- 11.1. There is no Accounting Standard for the not for profit sector, although the **Australian Accounting Standards Board (AASB)** investigated the development of such a standard in 2008.
- 11.2. An Accounting Standard should be developed with variations for different types of not for profit organisations and with different thresholds on scale of operations.
- 11.3. An Accounting Standard for the sector could apply to all not for profits, with only those entities receiving funds from government grants or public or benefactor fundraising needing to report to a higher level.

- 11.4. Associations Forum notes from our experience that the management accounting methodology called “Activity Based Costing” greatly aids internal financial understanding but it is not used widely enough.

12.All grants by government and funds raised by from the public should be disclosed

- 12.1. The broad fact of grant money being received should be publicly available. Details of how money is applied to acquit grant conditions between the grant making government or benefactor and the grant recipient need not be publicly disclosed.
- 12.2. Clearer practices and procedures for reporting on grants that stretch over different accounting years should be established, especially regarding their inclusion in the Balance Sheet.
- 12.3. The **Queensland University of Technology’s Centre for Philanthropy and Nonprofit Studies** has done excellent work in this area, especially with its standard Chart of Accounts.

13.State the Objects on which tax status is determined

- 13.1. Tax status is currently determined by the Australian Taxation Office examining the Objects in the constitution of the applicant not for profit organisation, or by an organisation self assessing its status. If the Objects meet a particular purpose, tax advantages will result.
- 13.2. Therefore, the Objects of a not for profit organisation need to be publicly disclosed.

TERM OF REFERENCE 1: The relevance and appropriateness of current disclosure regimes for charities and all other not-for-profit organisations

14. Disclosure by Companies Limited by Guarantee and Incorporated Associations is of varying usefulness

- 14.1. Most incorporated not for profit organisations are Companies Limited by Guarantee or Incorporated Associations under state or territory Acts, and there are statutory obligations under these legislative regimes.
- 14.2. The statutory obligations for Companies Limited by Guarantee are useful, but expensive for small entities.
- 14.3. The statutory obligations for Incorporated Associations under state or territory Acts are weaker and inconsistent, and we believe they are not well enforced for Incorporated Associations in some states and territories.
- 14.4. There are also statutory obligations relating to the Charitable Fundraising Acts in different states. These requirements vary from state to state and they must be standardised.

15. Annual Reports to Members of Companies Limited by Guarantee are useful

- 15.1. The financial reporting requirements of Companies Limited by Guarantee (a type of unlisted public company) are useful, and mainly higher than for Incorporated Associations.
- 15.2. Companies Limited by Guarantee are required to produce and annual report to members 21 days before the Annual General Meeting or four months after the financial year end. The annual report should include the directors' report, financial report and auditors report. The financial report needs to meet Accounting Standards.
- 15.3. These requirements should apply to all not for profit organisations above a certain financial size and to all those that receive public donations or government grants.

16. Introduce “Declaration of Financial Position” for smaller not-for-profits

- 16.1. The value to any organisation of an independent audit of its finances cannot be underestimated. Independent verification is the foundation of confidence in the financial situation of a not for profit organisation.
- 16.2. As well, because the closing figures from one year become the opening figures for the next year, all audited figures for one entity are linked to together to form a multi year picture.
- 16.3. However, independent audits may cost from \$3,000 upwards, so a threshold below which they should not be required is needed.
- 16.4. Below this threshold, Associations Forum believes a new annual “Declaration of Financial Position” should be introduced, where the governing council (or Board) should sign a declaration of Assets, Liabilities and Equity at year end. No independent verification of such figures is required and no exemptions should be given.
- 16.5. This Annual Declaration should be applied to all incorporated not for profit organisations across Australia not requiring other disclosure. Even if a small organisation has assets of only, say, \$75 and no transactions have occurred in the last year, a Declaration form should be submitted. If no transactions have occurred, it will not be a burden as it will be particularly easy to complete.

17. Give government grants only to transparent organisations

- 17.1. Government grants should only be given to legal entities that meet agreed high transparency requirements.
- 17.2. As stated previously, organisations that receive government grants should disclose these grants received in their Annual Reports.

18. Disclose donations to and from overseas

- 18.1. An example of a specific reporting requirement for a situation arises with Australian organisations that send money to other bodies internationally, and international groups that give money for expenditure in Australia. In these circumstances, special reporting requirements in an Accounting Standard would apply.

TERM OF REFERENCE 2: 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

19. Make all entities “Companies Limited by Guarantee”, hence governing bodies will be “Boards” and people on boards will be “Directors”

19.1. The University of Melbourne’s 2004 report, **A Better Framework: Reforming Not-For-Profit Regulation** (“the Woodward Report”), is the landmark report in this area and we broadly support its recommendations. This report was well researched in its methodology and practical in its recommendations.

19.2. The Companies Limited by Guarantee regime is the best “legal form” or vehicle for registration of not for profit organisations. We support all incorporated entities that are not already Companies Limited by Guarantee being converted to this form of incorporation, although amendments to the law may be required.

19.3. Associations Forum supports incorporation as Companies Limited by Guarantee regime because:

- The body of law relating to companies and directors duties is vast and generally appropriate
- The law is known already by many current and future directors due to other activities
- Not for profit organisations that are Companies Limited by Guarantee generally understand and pay greater attention to governance than committee members of Incorporated Associations.

19.4. Following a trial period, a five year timetable should be set for Incorporated Associations and other not for profit organisations incorporated under separate specific legislation to convert to Companies Limited by Guarantee.

19.5. Whilst a standard Commonwealth or identical state based Associations Incorporation Act could be introduced, we see no reason why not for profit organisations should be subject to a lesser form of governance than other legal entities in Australia.

20.A new suffix for Companies Limited by Guarantee other than “Ltd”

20.1. Companies Limited by Guarantee are “public companies” along with companies listed on the Australian Stock Exchange. However, the disclosure requirements are and should be different.

20.2. The suffix “Ltd” applying to both types of Public companies is confusing. We recommend a specific suffix such as “CLG” for Company Limited by Guarantee be introduced, or perhaps “CDO” for Cause Driven Organisation.

21.ASIC to be the Registry, but not necessarily the Regulator

21.1. Following our recommendation that all incorporated legal entities should be Companies Limited by Guarantee, it follows that ASIC should be the registry for all entities. ASIC has the systems in place to receive Director information and statutory returns, and these systems should be extended to all incorporated entities in Australia

21.2. The government is to be complimented on the Australian Business Register. ABN Lookup provides access to the publicly available information provided by businesses when they register for an Australian Business Number (ABN). Information on Income Tax Exemptions, GST Concessions, FBT Rebates and Deductible Gift Recipient endorsements is readily available for free.

21.3. This is a vitally important resource for anyone wishing to investigate the status of an entity or registered name in Australia, and the government is congratulated on this excellent service.

21.4. There are arguments for ASIC to be the Regulator as well as the Registry, but we believe it needs to be a separate division or else the regulatory function may be seen as less important than for commercial companies.

22. Entity information to be available free of charge

22.1. Associations Forum believes information on Directors, Annual Returns and Constitutions should be available on line free of charge via ASIC. In the age of ready access to information via the internet, it is disappointing that payment is required for anyone wishing to find out, for example, who the Directors of a charity are.

23. No special consideration for “social enterprises”

23.1. We assume “social enterprises” to be either private companies that have been established for to assist community causes or not for profit organisations that have been recently set up, often by a person called a “social entrepreneur”.

23.2. It seems the term social enterprise is new language to describe what has been happening in Australia for many decades: not for profit organisations are established for a cause.

23.3. We see no reason for any different treatment of social enterprises. They are either:

- private businesses where the principals own and can sell the equity
- not for profits with mutual ownership and voting membership.

23.4. The same rules must apply to social enterprises as to any other private or not for profit group.

23.5. We see no distinction between “social enterprises” that are emerging or established.

24. A regulator for the not-for-profit sector, not just charities

24.1. At present, regulation of the not for profit sector is sparse and ad hoc. We do not think the Australian Taxation Office is well placed to make decisions about tax status. A better role for the ATO would be to administer the taxation system based on tax status decisions made by a dedicated Regulator.

24.2. We refer to our earlier comment that a system of self regulation could be considered in lieu of a government regulator.

24.3. As mentioned previously, the United States has an advanced system for disclosure by not for profit organisations. The US system should be carefully considered by the Senate Economics Committee in its deliberations, although we believe it the US Internal Revenue Service that administers the service.

24.4. The UK has a Charities Commission, but we are unsure whether this includes non charity not for profits such as associations.

25. Inclusion of Religious Organisations in Regulation

25.1. Religious organisations should be included in any system of regulation of the not for profit sector. They need scrutiny as they often lack a voting member base and hence do not have the accountability that members have through Annual General Meetings.

TERM OF REFERENCE 3: Other measures that can be taken by government and the not-for-profit sector to assist the sector to improve governance, standards, accountability and transparency in its use of public and government funds.

26. Introduce “Declaration of Number of Voting Members”

- 26.1. The concept of Directors reporting to and being accountable to Members is a sound principle of governance. We believe this principle is compromised when the Directors are the only Members or more than 10% of Members.
- 26.2. Associations Forum recommends that an annual “Declaration of Number of Voting Members” be introduced. This should impose no extra work for not for profit organisations, as they should already know who their members are for their Annual General Meeting requirements.

27. Tighten up granting of charitable status

- 27.1. Greater clarity and tightening up is need in definitions of charities and application of charity status. Some organisations have been given charity status in an inconsistent and possibly inappropriate manner.

28. Consider whether voting membership is open to all, or limited to a defined few

- 28.1. The granting of charitable status should consider the voting membership of the entity seeking charitable status. If voting membership of a charitable status is small or limited, it should be less likely to be granted charitable status.
- 28.2. The membership of applicants for charitable status is not currently examined and it should be because voting membership offers built in accountability.

29.Payment of fees to a regulator

29.1. Consideration may be given to not for profit organisations over a certain financial size paying fees to a regulatory body or self regulatory body. The self regulatory body could be established as a Company Limited by Guarantee, with fee paying organisations as voting members.

30.Disclose Related Party Transactions and other transfers

30.1. Transfers of money totaling more than \$10,000 in one financial year from one not for profit organisation to another should be disclosed.

31.Clarification of “reporting entity” concept

31.1. The ‘reporting entity’ approach of deciding application of accounting standards needs to be clarified. Most not for profit organisations can choose to produce only ‘special purpose accounts’ because they select not to be ‘reporting entities’.

31.2. Associations Forum believes these concepts are not intuitively understood by the majority of not for profit organisations, and need to be revised to aid comprehension.

32.Disclose salaries

32.1. The salary range of senior executives of listed public companies needs to be disclosed, but this requirement does not apply to not for profit organisations.

32.2. Associations Forum believes that disclosure of executive salaries and benefits will aid transparency and will lead to better pay for staff in this section of the economy.

33. Conclusion

- 33.1. From its perspective of an organisation that has daily contact with associations and charities on practical matters, Associations Forum is pleased this Senate Inquiry is underway. The process of a number of interested parties communicating and preparing submissions has already been good for the not for profit/cause driven sector.
- 33.2. There are too many regulations for Australia, a county with a small population. As well as eliminating state and territory variations in laws, some parts of the sector may be over regulated compared to their small size, and others may require more disclosure.
- 33.3. Associations Forum believes more attention needs to be paid to the significance of voting members, who provide excellent oversight of a not for profit with “mutuality” rather than market ownership. The smaller the voting membership of an organisation, the less checks and balances and due process exist, hence the greater need for scrutiny.
- 33.4. Clearer rules and better regulation is an opportunity for the sector. If the development of standards is done in consultation with the whole sector, not just charities, we believe an excellent outcome can result.
- 33.5. Associations Forum Pty Ltd notes that this submission is made on behalf of the owners of this business, and not on behalf of any of its subscribers.

Appendix: Input from Makinson & d'Apice Lawyers

Sydney Law firm Makinson & d'Apice have extensive experience with not for profit organisations. Their response from Partner Vera Visevic to Associations Forum's invitation to provide input to the Senate Inquiry has been copied in full as it gives a first hand expert account of the difficulties caused by different regulations in the sector:

"The mishmash of different regulations affecting the Not For Profit (NFP) sector is exceptionally complex and varies enormously from state to state. The complexities involved in negotiating the myriad of state based taxes such as payroll tax, stamp duty, land tax and determining the various exemptions and concessions from federal, state to local governments increases the compliance burden on charities, and represents a huge diversion of resources into compliance measures.

For a NFP to determine which exemption, concession or endorsement they are entitled to, they are required to sift through numerous and considerably complex regulations which have often been compiled in an ad hoc manner by a variety of different regulators and by various levels of government, such as ASIC, the ATO, APRA and the various state fair trading and consumer protection authorities. For example, although a charity or NFP may be considered to be as such for one regulator or government authority, thereby entitling it to a certain exemption or concession, that same organisation may not be deemed to be a charity or NFP as far as another regulator or government authority is concerned, thereby disentitling it to other exemptions or concessions.

By its own account, one such regulator, the ATO, admits that the regulatory and reporting requirements of NFPs is burdensome, with the ATO's Commissioner, Michael d'Ascenzo, stating that, "*the current system of tax concessions provides an unnecessary layer of administrative costs and complexity...(for NFPs)*"¹

Clearly the current regulatory system is inappropriate for the large and diverse NFP sector.

Not surprisingly, in such a confusing regulatory environment where there are mounting levels of compliance and administrative requirements, scarce resources are being diverted away from the core service of NFPs and their benefit to the community.

Contributing to the complex regulatory reporting and compliance environment is the many differing legal organisational structures adopted by NFP's sector. In the sector there is everything from trusts, incorporated associations, companies limited by guarantee and entities established by statute. NFP entities established by statute and those NFPs regulated by State legislation might have few or no reporting obligations, whilst other NFPs are regulated by the federal regulator ASIC with extensive reporting obligations adding to their administrative and compliance burdens.

¹ Australian Government: The Treasury: 2005 Tax Expenditures Statement: December 2005 pp4-5

A further difficulty with regulation of the NFP sector is the fact that the fundraising aspect of charities is regulated by State legislation:

- In New South Wales, the legislation is the *Charitable Fundraising Act 1991*
- the *Public Collections Act* in Western Australia
- the *Collection for Charitable Purposes* in South Australia
- the *Charitable Collection Act* in the ACT
- the *Collection for Charities Act* in Tasmania
- the *Fundraising Appeals Act* in Victoria, and
- the *Collections Act* in Queensland.

With numerous differing reporting regimes, NFPs operating nationally or in more than one state must take considerable measures to be aware and updated as to their compliance and reporting requirements, or risk non compliance.

In our opinion, the existing legal framework and regulatory environment of the NFP sector is in need of a fundamental overhaul. Australian NFPs require a single regulator to ensure that NFPs work effectively within a single legal, accounting and governance framework in order to increase charities' efficiency and effectiveness and boost public confidence and trust."