

# **Productivity Commission Draft Research Report 14 October 2009: Contribution of the Not-for-Profit Sector**

## **Introduction**

The Consumer Protection Division of the Department of Commerce in Western Australia (Consumer Protection) is responsible for the administration of the *Associations Incorporation Act 1987*, the *Charitable Collections Act 1946* and the *Street Collections (Regulation) Act 1940*. As the agency responsible for regulation of incorporated associations and charitable fundraising in Western Australia, Consumer Protection has a broad interest in the operation of the not-for-profit sector and a specific knowledge of, and interest in, the regulatory regime.

Consumer Protection welcomes the opportunity to comment on the Productivity Commission Draft Research Report on the Contribution of the Not-for-Profit Sector (the report). This submission will focus on the issues identified in Chapter 6 of the report, which deals with regulation of the sector, and draft recommendations 6.1 to 6.4.

## **Regulation of Incorporated Associations and Charitable Collections in Western Australia**

### **The Associations Incorporation Act 1987 Review**

The *Associations Incorporation Act 1987* (the Act) provides a framework for regulation of not-for-profit organisations which allows incorporation at low cost and with minimal intervention by the regulator in the management of associations. The Act is currently under review.

The review of the Act has a long history dating back to 1996. Since that time there has been widespread consultation with diverse groups of stakeholders culminating in the tabling of the *Associations Incorporation Bill 2006* (the Green Bill) in the Western Australian Parliament in November 2006 for public comment for a period of 5 months until April 2007.

The review had sought to produce new legislation, having regard to a number of issues such as:

- community effectiveness;
- whether the changes achieve the best possible outcome in the most cost effective way for the majority of Western Australian incorporated associations;
- whether the changes could cause an undue burden or responsibility on volunteers;
- whether small and large organisations are treated differently; and
- whether these requirements appropriately match the resources of the community.

Consumer Protection is in the final stages of preparing a submission for Government to approve amendments to the Act arising from feedback and consultations.

## **Strengths of the Current Regulatory Regime**

In the view of Consumer Protection the current regulatory regime for incorporated associations in Western Australia has a number of strengths. Consumer Protection supports the view of the Productivity Commission (6.1) that the current system of regulation generally works well for small associations which operate entirely within one jurisdiction (the vast majority of incorporated associations).

In comparison with legislation in other jurisdictions, the current regulatory regime in Western Australia combines a high level of support for incorporated associations with minimum intervention.

- The costs of administering the regulatory regime are highly subsidised. Cost recovery for the service is estimated at around 7%. Fees are kept low in recognition of the social and community value provided by incorporated associations. There are no ongoing fees relating to maintenance or renewal of registration.
- Incorporated associations are required to keep accounting records which correctly record the financial transactions and position of the association, and to prepare an annual report for members, but there is no requirement for incorporated associations to have accounts audited, or to provide an annual financial return to the Department. As noted above, the *Associations Incorporation Act 1987* is currently under review and the proposed amendments will require audit of the accounts of large associations. Smaller organisations will submit an annual return confirming their ongoing eligibility for incorporation.
- Consumer Protection produces and distributes educational materials including a regular newsletter and comprehensive guide to governance (known as the Inc. Guide) which is updated periodically. In addition to being available on the Department website, the Inc. Guide has been distributed in disc form to all incorporated associations in Western Australia. There is also an active education and compliance program. Information sessions and proactive compliance activities (including surveys) are undertaken in regional and metropolitan areas.
- Processing staff conduct a thorough review of all documents filed by associations to assist associations with the process of incorporation and ongoing operation, and to ensure that proposed rules are effective and compliant prior to registration. They also operate a dedicated advice line for incorporated associations.

## **The Green Bill**

### **Proposed changes in the financial accountability requirements for incorporated associations under the Green Bill**

Under the *Associations Incorporation Act 1987* an incorporated association is required to keep accounting records and provide an annual statement of the association's financial position to members. There is no requirement for the incorporated association to have its financial statements audited.

The Green Bill proposed a three tiered system of financial accountability for incorporated associations with auditing requirements determined by the association's annual turnover and net assets.

The rationale for the three tiered system of financial accountability arose from the need for incorporated associations to be financially accountable to their membership, although it was also recognized that there was a need for different auditing requirements depending on the size, scale and complexity of an association's activities.

### **Subsequent changes in policy direction on the proposed financial accountability provisions in the Green Bill**

Following feedback from the submissions on the Green Bill it was clear that the proposed auditing requirements were too great an impost for smaller associations. In addition there was concern from the accounting profession that there would not be enough accountants and auditors to adequately provide auditing services to associations under the proposed changes.

As a result a two tiered approach to audit and financial accountability is proposed. Assets would not be taken into account in determining the tier into which an association would fall. The proposed classification of associations into two tiers would be as follows.

- Tier 1 will include smaller associations with income or revenue of less than \$500,000 per annum. These associations must provide their members with financial statements for that year, reflecting the financial circumstances of the association at an Annual General Meeting. There is no requirement to have the financial accounts audited although an association may do so if it chooses.
- Tier 2 will include larger associations with income or revenue of, or in excess of, \$500,000 and these associations will be required to have their accounts audited for presentation at the Annual General Meeting.

The South Australian *Associations Incorporation Regulations 2008* provides that \$500,000 is the threshold for those incorporated associations defined as "prescribed associations" in section 3(1) of the *Associations Incorporation Act 1985 (SA)*. Prescribed associations under the South Australian Act are required to be audited. While an \$500,000 threshold similar to that operating in South Australia is proposed, a final position on financial accountability for Western Australia is yet to be confirmed through the Cabinet process.

### **The Recommendations of the Productivity Commission:**

The following comments are made with respect to draft recommendations 6.1 to 6.4 and specific issues raised by the Commission with regard to those recommendations.

#### **Draft Recommendation 6.1**

***The Australian Government should establish a Commonwealth incorporated associations legal structure for not-for-profits. The new legal structure would assist not-for-profits, in particular, those operating across State and Territory boundaries that do not wish to be companies limited by guarantee but wish to be incorporated at Commonwealth level.***

***Australian governments should ensure that incorporation legislation is amended to allow not-for-profits to migrate from one form of legal entity to another and to migrate between jurisdictions.***

***State and territory governments should continue to reduce unnecessary compliance requirements for incorporated associations.***

It is estimated that not more than 5% of the 15,700 associations currently incorporated in Western Australia would operate in other jurisdictions, but for those associations which are affected, this proposal would appear to offer significant benefit.

Consumer Protection is aware of a perception on the part of larger incorporated associations that the only structure currently available at Commonwealth level, that of a company limited by guarantee, is not ideally suited to their needs.

The following comments are made in response to specific questions posed by the Commission with regard to this recommendation:

***Is there a need for a new legal form for small unincorporated associations, providing limited legal rights?***

Consumer Protection is not aware, in conducting its education and compliance activities, of any demand within the sector for a new legal form. In our view, focus should be on reducing the costs and compliance burden associated with incorporation as much as possible and providing support services at low or no cost to make this legal form accessible to small organisations. In furtherance of this aim, the proposed changes to incorporated associations legislation in WA would reduce the cost of incorporation by eliminating advertising fees.

Provided that incorporation as an association is offered at low cost with minimum regulatory intervention, an additional layer of regulation would appear to be unnecessary and would potentially have undesirable consequences. If legal recognition is automatic rather than dependant on registration (as described at 6.17), small organisations that to date have preferred not to have legal entity status will be denied the option of remaining free from government intervention (by virtue of obligations arising with their new status). If legal recognition is dependant on registration, the further administrative burden would be introduced without, in our view, significant benefit.

***Whether State/Territory based incorporation should be restricted to not-for-profits with income less than \$150,000 per annum.***

A regulatory regime which imposes appropriate reporting and audit requirements as the size of an organisation increases would be consistent with the proposed changes for Western Australia. Increased size would tend to indicate more complex operations, greater difficulty in ensuring accountability to the membership and a higher level of risk.

As noted above, the current proposal for new regulation in Western Australia is for more rigorous compliance requirements to apply to associations with income in excess of \$500,000 per annum which would be incompatible with a suggested restriction on State incorporation to not-for-profits with income of less than \$150,000 per annum. The figure of \$500,000 was selected after industry consultation and on that basis it is suggested that an income test of \$150,000 is quite low. At that level, associations would have limited economic significance and the burden of stricter reporting requirements would not be in proportion to the level of risk associated with their activities.

While Consumer Protection would have no opposition to making a Commonwealth incorporated associations structure available to larger associations, there is no necessity to restrict State/Territory registration to small associations, provided that large associations are subject to an appropriate compliance regime under State legislation which is consistent with that applicable under a Commonwealth regime.

The *Associations Incorporation Act 1987* contains, at section 9(2)(a), a provision which prohibits the incorporation of an association if, in the opinion of the Commissioner, it is more appropriate for the activities of the association to be carried on by a body corporate incorporated under some other law. If a Commonwealth incorporated association form is introduced which, in the view of the Commissioner is a more appropriate vehicle for the registration of particularly large or complex associations, the Commissioner would be obliged to refuse to register such organisations under the current regime. This provision does not, however, apply retrospectively and organisations currently registered as incorporated associations could not be compelled to change to another form.

***How governments can free up the ability of organisations to migrate between legal forms and jurisdictions, while guarding against any undesirable consequences from forum shopping.***

There are currently substantial barriers to migration between forms and jurisdictions. The current legislation in Western Australia does not permit an incorporated association to transfer to registration as a company limited by guarantee. This is expected to be addressed in the proposed amendments to the Act. It is noted that associations might also face barriers in the form of stamp duty and taxation obligations.

Free migration between forms and jurisdictions would be advantageous, allowing "best fit" to be achieved when initial choice of form is not appropriate, or when there is a change in circumstances.

Free migration between forms and jurisdictions should not create a problem with 'forum shopping' provided that legislation in each jurisdiction is consistent and compliance requirements are appropriate. To this end, Consumer Protection would support efforts to harmonise governance and reporting requirements between jurisdictions for organisations with a similar size and risk profile. Recent amendments to incorporated associations legislation in Queensland and NSW, reducing compliance requirements (6.12), have created a more consistent regime for small associations. Other jurisdictions are also considering amendments.

A provision in the legislation in each jurisdiction preventing registration of an organisation where another more appropriate form exists (such as section 9(2)(a) of the *Associations Incorporation Act* described above) would also prevent an organisation from choosing an inappropriate form or jurisdiction.

## **Draft Recommendation 6.2**

***To promote confidence in the not-for-profit sector and reduce regulatory burden Australian Governments, initially through the COAG Business Regulation and Competition Working Group, should:***

- ***Agree to implement harmonised fundraising regulation and mutual recognition across Australia.***
- ***Support the development of a fundraising register for cross jurisdictional fundraising organisations, to be administered by the proposed national Registrar.***
- ***Endorse the adoption by all governments of the Standard Chart of Accounts for reporting by not-for-profits in receipt of government grants or service contracts.***
- ***Ensure that the Standard Business Reporting initiative be expanded to include reporting requirements by not-for-profits***

## **Fundraising Regulation in Western Australia**

A draft Public Collections Bill (the Bill), intended to update the regulation of both charitable collections and street appeal collections, repealing the *Charitable Collections Act 1946* and the *Street Collections (Regulation) Act 1940* (the charitable collections legislation) was released for public consultation in June 2002.

The rationale for the drafting of new legislation was based on the changes in the charitable sector since the charitable collections legislation was drafted. New types of organisations and new methods of fundraising have evolved and the concept of what is a "charitable purpose" has changed. Many charities now use paid staff rather than volunteers, commercial fundraisers are more widely used, and the general public has become more concerned about the uses to which funds raised are actually put. It is also difficult for members of the public to ascertain how charities apply the funds they receive.

The potential for mismanagement and fraud by unscrupulous operators and the unique features of the charitable sector, as well as its use of direct approaches in fundraising, provided a strong rationale for closer regulation of the sector.

## **The Draft Recommendation**

Consumer Protection recognises that the current requirement for national fundraisers to be licensed in multiple jurisdictions, and to provide several financial returns which contain different information in different formats, places a significant administrative burden on those organisations. As noted by the Commission, substantial differences currently exist between jurisdictions, making any form of mutual recognition impractical without legislative change. Implementation of harmonised fundraising regulation, at least as regards key elements such as standard definitions and reporting requirements will be necessary to address the concerns of these organisations and facilitate any proposed scheme of mutual recognition.

Within the confines of a system of harmonised legislation and mutual recognition Consumer Protection can see advantages in retaining access to specialist local knowledge in administering the regime (currently provided by the Charitable Collections Advisory Committee in this State) and the ability to protect consumers in Western Australia by prohibiting organisations from fundraising when they are found to have engaged in misconduct – regardless of licence status in other jurisdictions.

One difficulty currently faced by regulators of charitable collections and fundraising is the lack of a forum for communication. As fundraising is regulated by different government agencies in different jurisdictions there is limited opportunity for discussion and co-operation. Any new regulatory regime should provide for ongoing consultation between all regulators including the proposed Commonwealth Registrar.

With regard to the Standard Chart of Accounts, Consumer Protection also is of the view that adoption of the chart by government funding agencies would reduce the reporting burden for grant recipients. It is noted, however, that the Standard Chart of Accounts has wider application. It provides a low cost tool that can be used by small not-for-profit groups, with limited access to professional financial advice, to improve governance and enhance performance, particularly for those organisations which wish to use the financial information in strategic planning. Committee members of incorporated associations are often actively involved in the management of a number of associations, particularly in rural and regional areas. Use of a standard chart of accounts by small incorporated associations introduces a degree of consistency which allows managers and members to move more easily between roles and organisations.

Use of standardised definitions in reporting also makes information provided to members and regulators much more useful. It provides a more complete and comparable picture of performance where the information is available to members of the public, for example, potential donors seeking information on charities from a public register.

### **Draft Recommendation 6.3**

***The Australian Government should adopt a statutory definition of charitable purposes in accordance with the recommendation of the 2001 Inquiry into the definition of charities and other organisations***

A clearer and more consistent definition of charitable purpose would be of benefit to fundraisers and donors. Based on public consultations conducted by Western Australia with regard to the draft Public Collections Bill in 2002, the definition developed by the 2001 inquiry appears to have broad industry support, at least as a starting point for discussion and consultation.

### **Draft Recommendation 6.4**

***The Australian Government should establish a one-stop shop for Commonwealth regulation by consolidating various regulatory functions into a new national Registrar for Community and Charitable Purpose Organisations with the following key functions to promote confidence in the not-for-profit sector:***

- ***Register and regulate Commonwealth incorporated associations, companies limited by guarantee and Indigenous corporations.***

- ***Register and endorse not-for-profits for Commonwealth tax concession status.***
- ***Register cross jurisdictional fundraising by not-for-profit organisations.***
- ***Provide a single reporting portal for public record corporate and financial information, proportionate to the size and scope of functions of not-for-profit organisations***
- ***Provision of appropriate governance education.***
- ***Complaints handling.***

Consumer Protection can see advantages in adopting agreements in relation to working practices which simplify processes for organisations dealing with multiple government agencies. It is noted that the primary impact of this proposal will be on the regulatory activities and support services provided by the Commonwealth. The recommendation is not inconsistent with the regulatory regime in Western Australia.

A national register of information on fundraisers would be a valuable resource for members of the public. Financial information currently provided to the Department by licensed charitable collectors is not available to the public, limiting the ability of donors to make an informed choice about the organisations they support.

Consumer Protection sees benefit in ensuring that obligations for fundraisers which are proportionate to the size and scope of functions of the organisation. It is noted that small organisations, such as local service clubs, find current charitable collections licensing requirements onerous. Reporting and audit obligations attaching to the licence are not tailored to take account of the level of risk associated with the activity. All organisations raising funds from the public should report in some form, but reporting obligations should be proportionate to the level of risk with the burden of such reporting reduced as far as possible for small local organisations.