



Regulatory reform for the not-for-profit sector — is real change now likely?

By **Sue Woodward**, Manager and **Nathan MacDonald**, Lawyer, PilchConnect

- *NFP sector faces a complex network of compliance obligations but Australia has not progressed in reforming regulatory requirements*
- *Senate Committee report makes encouraging recommendations for reform and establishment of taskforce to see through implementation*
- *National accounting standard still to be developed*

In the current period of economic volatility, philanthropic bodies and the broader not-for-profit (NFP) sector will be relied upon more than ever. However it is a double-edged sword for NFPs: while demand on their services increases, funding opportunities are contracting as philanthropic and corporate benefactors themselves grapple with reduced returns on investment and decreasing profit margins. Survival for many NFPs will, more than ever, depend upon the efficient use of resources. Precious resources should not be wasted on regulatory compliance that is unnecessarily complex and riddled with inconsistencies.

In such a climate, the Federal Government's interest in regulatory reform across the so-called 'third' sector is timely and welcome. As articulated in the recent Senate Committee report, appears to be strengthening public and government confidence in the sector through appropriate disclosure regimes, underpinned by national regulation on issues such as legal structures and fundraising. In our view, the goal of appropriate accountability cannot be achieved without

improvements on the fundamentals. Many of the current complexities and inconsistencies that frustrate those within the NFP sector (and which PilchConnect hears about on a daily basis) stem from the myriad of legal structures and divergent state-based legislation. These barriers to accountability and efficient regulation are exacerbated by the lack of a national specialist regulator and a NFP-specific accounting standard.

But beware — this well-intentioned reform agenda should not be about more regulation, but about *better* regulation. Despite previous inquiries and academic research¹ into many of the discrete issues affecting the sector (for example, definition of charity 2001²) or into discrete parts of the sector (for example, community welfare organisations 1995³), the 2008 Senate Standing Committee on Economics Inquiry into *Disclosure regimes for charities and not-for-profit organisations* (the Senate Inquiry) is significant and unique because it represents an overarching consideration of the regulatory issues that have an impact on the efficiency and accountability of the NFP sector as a whole.

This article explores the background to the Senate Inquiry, the key recommendations endorsed by the Committee (December 2008)⁴, and what might be the next steps for government in order to achieve systemic and suitably tailored NFP regulatory reform.

Importance of NFP sector

In economic terms, Australian Bureau of Statistics⁵ estimates show that the NFP sector contributes more to GDP than the communications industry. If an imputation is made for the value of services provided by volunteers, the adjusted gross value of the sector's contribution is 4.9 per cent of GDP. The most recent ABS figures show that the sector received \$74.5 billion in income for the 2006–2007 financial year, but even this figure excludes those NFPs that have not registered for an ABN.⁶

Of course, these figures do not take into account the qualitative contribution of the sector, for example, the role it plays fostering a healthy democratic society and, using popular terminology, its role in supporting social inclusion. This, combined with the significant role the sector plays in the delivery of government services and the concessional taxation treatment many NFPs receive (for example, income tax exemptions, deductible gift recipient status), means it is right to expect public accountability about matters such as sources of funding and how they are expended.

Background to NFP regulatory reform

Over the last decade, the sector has spent vast resources providing submissions to government to explain the complex regulatory issues its members face in their day-to-day operations. The frustrating lack of progress is highlighted in the Law Council of Australia submission:

In the last 15 years, the NFP sector (including charities) has been the subject of four major Commonwealth Government Inquiries and consultations.....The Law Council notes that the Commonwealth Government has never released a final response to first report [1995 Industry Commission], has implemented only a small part of the second report [2001 charity definition], has not implemented the third report [2003 Board of Taxation consultation on the draft charities Bill] and that no report has been released in relation to the fourth submission [2007 Treasury paper unlisted public companies].⁷

So, while previous Federal Governments have made regulatory reform a priority in the ‘for-profit’ sector (particularly with a focus on assisting small business), Australia has gradually fallen behind other jurisdictions on regulatory standards applicable to NFPs.

It surprises many people familiar with the business sector to know that the regulatory environment for NFPs is even more complex than for business.⁸ It is our experience that even with the best intentions, this complexity, combined with the absence of both a proactive and supportive regulator and access to affordable legal information and advice, means that many small-to-medium NFPs cannot readily ascertain or understand their compliance obligations.

Impetus for Senate Inquiry

So, what sparked the fifth Federal inquiry on NFPs in the last 15 years? It should have been a response to pleas from within the sector for reform and/or because of concerns highlighted by previous inquiries. Or even because, after years of reforms for business, the government finally ‘got around to’ the NFP sector. Yet, as is often the case in politics, the ‘trigger’ for the Senate Inquiry was negative press⁹

combined, in this instance, with a motion by former Democrat Senator Lyn Allison.

However, the Senate Inquiry would not have gained any traction but for the Rudd Government’s interest in the area. Refreshingly, it indicated a commitment both before and after the 2007 Federal election to improving the regulatory environment for NFPs.¹⁰ Early on in office, Senator Ursula Stephens, (Parliamentary Secretary for Social Inclusion and the Voluntary Sector) confirmed ‘reform programs to date have generally ignored the sector’ and acknowledged that ‘inconsistencies exist across jurisdictions, making it a difficult maze for community organisations to navigate.’¹¹

By way of other political context, it is worth noting that the Federal Government has been consulting with the NFP sector about a possible ‘National Compact’¹² and has plans for a referral to the Productivity Commission about measuring the social impact of the sector.

Terms of reference

The Senate Committee (Chaired by Senator Annette Hurley, South Australia, ALP) was given the enormous task of inquiring into the Australian NFP sector with a focus on the examination of:

- the relevance and appropriateness of current disclosure regimes for charities and all other NFP organisations
- models of regulation and legal forms that would improve governance and management of charities and NFP organisations and cater for emerging social enterprises and
- other measures that can be taken by government and the NFP sector to assist the sector to improve governance, standards, accountability and transparency in its use of public and government funds.

As with previous NFP inquiries, a significant number of submissions (in this case 183) were received — most from NFP sector groups. PilchConnect put in a detailed submission (endorsed by others) which can be viewed on our new legal web portal (<<http://www.pilchconnect.org.au/PCLawReform>> [30 January 2009]). [Editor’s note: Chartered Secretaries Australia also made a submission to the inquiry on 20 August 2008, available at <<http://www.CSAust.com>>.]

Recommendations

On 4 December 2008, the Senate Committee released its report.¹³ The Committee endorsed 15 recommendations which focus on reform of the existing regulatory scheme for NFPs in Australia and, we are pleased to say, adopting the majority of the recommendations made by in the PilchConnect submission. The key recommendations are:

- the establishment of a single, independent,

national regulator to provide oversight of the NFP sector (not just the smaller 'charitable' subset of the sector as is the case in the UK and New Zealand)¹⁴

- introduction (by way of a referral of powers from the states) of nationally consistent laws on legal structure and fundraising¹⁵
- creation of a position of 'Minister for the Third Sector'¹⁶ and
- the establishment of an expert taskforce to manage the implementation of the Senate Committee's recommendations.¹⁷

The Senate Committee also recommended that all NFPs should be required to migrate to the proposed single legal structure¹⁸, and concluded that there should be a tiered reporting system with disclosure obligations commensurate with the size of the organisation.¹⁹

With regard to the type of reporting, the Committee recommended that (in addition to numerical data) disclosure should include information in a narrative form 'in acknowledgement that the stakeholders of the Sector want different information to that of shareholders in the Business Sector'.²⁰ To further promote transparency within the sector, the Committee makes recommendations for an online database to be managed by the proposed regulator with publicly available information to include the aims and activities of NFPs.

An examination of the Senate Inquiry report reveals a struggle to achieve a balance between safeguarding public confidence in NFP governance through transparency and accountability, with ensuring that reforms will not impose too great a burden on a sector that is already strained for resources and which could have the effect of negating the social benefits many groups provide.

We will now consider some of the key recommendations in a little more detail.

Single legal structure for all NFPs with tiered reporting obligations

A significant number of inquiries received by PilchConnect relate to individuals or groups seeking guidance on how to structure NFP ventures. There is a high level of confusion at this initial stage, and this is one example of how regulation is more complex than for business. According to the National Roundtable for Nonprofit Organisations²¹ there are, at present, more than 20 different ways to incorporate a NFP organisation in Australia including incorporated associations, companies limited by guarantee, proprietary companies, trusts, cooperatives and indigenous corporations. The multiplicity of available structures is a product of both the federal-state dichotomy and the existence of a

variety of specialist forms of incorporation (for example, trade unions and school associations). What structure is likely to best meet the needs and resources, both now and in the longer term, is often a difficult decision for a group even if legal assistance can be obtained.

A key recommendation of the Committee is that 'a single, mandatory, specialist legal structure be adopted for NFP organisations through a referral of state and territory powers'.²² The Committee determined that it would be preferable for *all* NFP organisations to use the same legal structure as a means of ensuring 'the most effective and efficient regulation of the sector'²³, with all NFPs reporting to the same body and what is disclosed being commensurate to their level of annual revenue.²⁴

Several complex issues arise from these recommendations, which we can only briefly touch upon here.

1. Should there be just one possible legal structure for NFPs?
2. Should there be a tiered reporting regime linked only to annual revenue?
3. Should the reforms be achieved by a referral of powers from the states?
4. Should there be mandatory migration of existing organisations?

The PilchConnect submissions to the Senate Inquiry and the 2007 Treasury Inquiry²⁵ cover all but the last of these points, including providing some case studies.

Only one NFP legal structure?

On the first point, we believe rationalising the number of possible legal structures is a good thing but would not recommend only one option.²⁶ A single structure would be extremely difficult to implement across all existing NFP legal forms and would put NFPs at a relative disadvantage compared to business. It is, however, timely to consider a new specialist NFP legal structure, probably best achieved as a modification of the incorporated association structure that the vast majority of incorporated groups currently operate under. Reform of this legal structure could (subject to the mandatory migration point discussed below) alleviate the practical issue of having to choose between a company limited by guarantee or an incorporated association. It would enable NFPs to benefit from the best aspects of the company limited by guarantee and incorporated association models, while drawing on the UK experience of 'community interest companies'.

Tiered reporting?

Second, PilchConnect supports a tiered reporting model but has repeatedly cautioned that it is not as simple as adopting for NFPs the definitions

currently applied to ‘small’ and ‘large’ proprietary companies under the *Corporations Act 2001*. Much about what reforms are needed to improve disclosure turns on:

- *what should be reported* — the need for a NFP-specific accounting standard and (we agree) greater use of a narrative on how funds have been applied
- *to whom the reports should be made* — to a regulator that considers the information and makes it freely available to the public (again we agree with the Senate Committee) and
- *at what cost* — auditing costs can be a huge burden for small NFPs and filing fees, if any, must be scaled.

Referral of powers?

We congratulate the Senate Committee in its recommendation about a referral of powers as the way to achieve a nationally consistent approach thereby ensuring we can avoid the tortuous path taken to achieve a truly national model for corporations law (which included unsuccessful attempts at harmonisation across states).

Mandatory migration to new structure?

The last point is a very difficult one and it became a contentious issue at one of the Senate Committee hearings.²⁷ Professor Myles McGregor-Lowndes stated that NFPs (particularly small organisations) may perceive this reform as government ‘wanting them to morph into being supernational incorporated associations’ and, therefore, he suggested it is better to entice them into the regime with the pitch that this is a ‘super new legal form designed just for them’.²⁸

He makes a good point but we suggest, on balance, the arguments come down in favour of mandatory migration of at least existing incorporated associations, thereby collapsing the separate state and territory based regimes into one. Without deeming existing associations to be incorporated under the new regime, the number of possible legal structures (and regulators) will increase, thereby exacerbating the existing problem.²⁹ If there is a choice to be made (for example, to transfer or not) this will place a burden on the many thousands of very small organisations who have no ability to access specialist legal advice. However, in recognition of the likely confusion and concern in the sector, we believe it is critical that resources be allocated for an education program to explain the reforms.

What should happen for existing NFPs incorporated under other legal structures is more problematic. We suggest those incorporated as companies limited by guarantee should also be transferred to the new regime but with an ‘opt out’ mechanism for any that can show good reason why

the new regime would not suit their particular needs. Other groups (such as cooperatives) should be left out at this stage.

Establishment of an independent, national NFP regulator

The Australian Taxation Office (ATO) currently provides de facto regulation of the sector because it determines an organisation’s charitable or other eligibility for various taxation concessions. This is combined with regulation by ASIC and a variety of state regulators depending on the organisation’s legal structure and activities (such as fundraising).

This mix of regulators is recognised by all as creating confusion and complexity as well as being inefficient.³⁰ It does not fit within the Australian Securities and Investments Commission’s (ASIC) business oversight role (those NFPs already under its jurisdiction as companies limited by guarantee are a very small fraction of the total number of companies), and the ATO has repeatedly (and we believe properly) stated that it does not want this role.³¹

One of the recommendations put to government following the 2001 Charity Definition Inquiry was for the establishment of a national, ‘independent administrative body to oversee charities and related entities’. While this recommendation was never acted upon, the 2008 Senate Inquiry report affirms this approach. The Committee notes that while ASIC is currently the most logical agency to assume this regulatory function, it is preferable that responsibility for the NFP sector is passed to a new administrative body, as ASIC’s ongoing regulation of the ‘for-profit’ sector gives rise to fundamentally different issues when contrasted with those faced by NFPs. The Committee correctly notes that ‘to take on the entirety of the [NFP] Sector would require a culture change within’ ASIC.³²

This recommendation by the Senate Committee reflects the view of the majority of the submissions and is strongly supported by PilchConnect. However, the effectiveness of an independent regulator will be contingent on the resources allocated to its establishment and ongoing operations (an under-resourced body is likely to exacerbate current problems). Further, to be effective we need a regulator whose mission is to understand and support a vibrant, transparent and accountable NFP sector by judicious exercise of both ‘teeth’ and ‘touch’ — that is, one that can sense when to act with full enforcement powers and publicity, and when to educate and support.

The Committee did not make a firm recommendation as to how the new regulator would be funded, but indicated that the suggestions provided by PilchConnect should be explored further, namely:

- exploring the use of the significant experience and resources of ASIC for the online data collection, storage and searching aspects, possibly in conjunction with a sector-managed resource database
- cost sharing with the states because of savings achieved by no longer needing separate regulators in each state and territory
- cost savings achieved by fewer staff required in the ATO (its role will be to apply the revenue laws rather than having to determine eligibility) and
- cost savings to the NFP sector by a reduction in red tape and, therefore, greater capacity and efficiencies in delivery by NFPs of government / public funded services.³³

Although not within its actual recommendations, it is interesting to note that the Senate Inquiry report states 'Under a single, national regulator, ORIC [Office of the Registrar of Indigenous Corporations] would cease to operate as an entity. The new regulator would assume the responsibility of regulating indigenous' NFPs.³⁴

A Minister for the third sector

The Senate Inquiry recommended the appointment of a Minister with responsibility for the NFP sector, together with a specialist unit within the Department of Prime Minister and Cabinet. This recommendation mirrors the approach in place in United Kingdom since 2006.

While the Rudd Government has the established role of Minister for Social Inclusion (Deputy Prime Minister Julia Gillard) which is supported by a Parliamentary Secretary for Social Inclusion and the Voluntary Sector (Senator Ursula Stephens), a ministerial position for the broader NFP sector is a welcome opportunity for ensuring sector issues remain high on the government's agenda. Without a powerful champion within government it is clear from the fate of previous inquiries that the necessary reforms will not be implemented.

Given the NFP sector contributes (with imputation for volunteer time) more to GDP than the mining sector³⁵, a ministerial position specific to the sector is certainly appropriate.

Implementation taskforce

How can any of these recommendations become reality? The Committee adopted PilchConnect's recommendation for the establishment of a specialist taskforce to oversee the implementation of the Inquiry's recommendations. Such a taskforce is one possible mechanism for ensuring that the measures of reform suggested by the Senate Committee do not impose an unreasonable reporting burden on small and micro NFP

organisations. The Committee has recommended that the taskforce report to the Council of Australian Governments (COAG) on a quarterly basis and should continue to meet until such time as all of the recommendations are implemented.

Is anything missing?

An omission from the Inquiry's report is the absence of any recommendation regarding the development of a national accounting standard for the NFP sector. The Inquiry received evidence from the Australian Accounting Standards Board (AASB) that the AASB 'would not be inclined' to look at standards specific to NFPs without first 'having an international precedent'.³⁶ We think this is not a sufficient answer to the problem. However, the Senate does take note of the excellent work being undertaken by the Australian Centre for Philanthropy and Nonprofit Studies at the Queensland University of Technology and recommends that government work with the NFP sector 'to implement a standard chart of accounts for use by all departments and Not-For-Profit Organisations as a priority'.³⁷

Where to from here?

This most recent call for reform of the NFP sector from a long line of Federal forums represents an opportunity for the Rudd Government. PilchConnect and others within the sector will closely monitor the government's response to the Senate Inquiry. It would be encouraging to see the proposed specialist taskforce take shape in the very near future. With the Senate Committee's report as the road map of what is needed, State and Federal governments must work together to implement the key recommendations.

Otherwise, the Rudd Government will fall victim to the fate of its predecessors and miss an opportunity to better regulate and enhance a sector that has immense economic and social significance for Australia, particularly in times of economic turmoil.

PilchConnect (<http://www.pilchconnect.org.au>) is a specialist legal service established to provide free or low cost legal information, training and advice to not-for-profit community organisations. Based within the Public Interest Law Clearing House (Vic) Inc (PILCH, which is itself a NFP), PilchConnect 'helps the helpers' by promoting good governance among NFPs and assisting them to understand and deal with their regulatory obligations. It draws on PILCH's 14 years of experience of brokering pro bono legal assistance for not-for-profit groups and, therefore, has considerable knowledge of the regulatory issues they face.

Sue Woodward can be contacted via email at Sue.Woodward@pilch.org.au. Nathan MacDonald can be contacted via email at Nathan.MacDonald@pilch.org.au. Both can also be contacted on (03) 8636 4400.

Notes

- 1 See Woodward S and Marshall S, 2004, *A Better Framework: reforming not-for-profit regulation*, The University of Melbourne, Centre for Corporate Law and Securities Regulation, <<http://cclsr.law.unimelb.edu.au/go/centre-activities/research/reforming-not-for-profit-regulation-project>> [30 January 2009]. See also many articles by Professors Mark Lyons and Myles McGregor-Lowndes: for recent examples see McGregor-Lowndes M, 2007, 'Driving forward whilst looking into the rear vision mirror', *Philanthropy Australia Journal*, Summer 2007, Issue 67 and Lyons M, 2007, 'Third Sector Opportunities and Challenges: A Four-Sector Analysis', *Third Sector Review*, Vol 13 No 2, pp 9–26
- 2 *Inquiry into the Definition of Charities and Related Organisations*, 2001: <<http://www.cdi.gov.au>> [30 January 2009]
- 3 Industry Commission, 1995, *Charitable Organisations in Australia*, Report No 45, AGPS, Canberra
- 4 See Senate Inquiry Report <www.aph.gov.au/senate/committee/economics_ctte/charities_08/report/index.htm> [30 January 2009]
- 5 ABS, 2001, *Australian National Accounts: Non-Profit Institutions Satellite Account, 1999–2000*, Pub No 5256.0
- 6 NFPs with an annual turnover of less than \$150,000 are not required to register for an ABN although some choose to do so
- 7 See p 6 Law Council submission to Senate Inquiry available at <http://www.aph.gov.au/Senate/Committee/economics_ctte/charities_08/submissions/sub128.pdf>
- 8 See also Allens Consulting Group, 2005, *Improving Not-for-Profit Law and Regulation*, August, commissioned by the (then) Department for Victorian Communities, and Victorian State Services Authority, 2007, *Review of Not-for-Profit Regulation*
- 9 See an article in *Choice* magazine published online in March 2008 which highlighted the wide variability and inconsistent the way in charities disclose information to the public: <<http://www.choice.com.au/viewArticle.aspx?id=106240&catId=100268&tid=100008>> [30 January 2009]
- 10 See ALP pre-election policy at <http://www.alp.org.au/download/now/071122_social_inclusion.pdf> [30 January 2009] and later statements by Senator Ursula Stephens at the Non-Profit Forum at <<http://www.ursulastephens.com>> [30 January 2009]
- 11 Extracts from speech by Senator Ursula Stephens at the Australian Council for International Development Forum, available at <www.deewr.gov.au/Ministers/Stephens/Media/Speeches/Pages/Article_081015_150441.aspx>
- 12 See most recent communiqué <http://www.socialinclusion.gov.au/A_National_Compact/National_Compact_Expert_Panel_Communique_15Dec2008.htm> [30 January 2009]
- 13 See Senate Standing Committee on Economics *Disclosure regimes for charities and not-for-profit organisations*, 4 December, 2008: <http://www.aph.gov.au/senate/committee/economics_ctte/charities_08/report/index.htm> [30 January 2009]
- 14 See recommendation 3, para 5.46, Chapter 5 : Senate Inquiry Report
- 15 For legal structure see recommendation 7, para 7.59 and paras 7.45 to 7.47, Chapter 7; for fundraising see recommendation 9, paras 9.14 to 9.15, Chapter 9: Senate Inquiry Report
- 16 See recommendation 2, para 4.22, Chapter 4 Senate Inquiry Report
- 17 See recommendation 15, para 11.7, Chapter 11 Senate Inquiry Report
- 18 See recommendation 7, para 7.59 and paras 7.40 to 7.44, Chapter 7 Senate Inquiry Report
- 19 See recommendation 10, para 10.24, Chapter 10 Senate Inquiry Report
- 20 See recommendation 11, para 10.52, Chapter 10 Senate Inquiry Report
- 21 Nonprofit Regulation Reform Program: An initial statement by the National Roundtable of Nonprofit Organisations available at <<http://www.nonprofitroundtable.org.au>>
- 22 See recommendation 7, para 7.59, Chapter 7 Senate Inquiry Report
- 23 See para 7.58, Chapter 7 Senate Inquiry Report
- 24 See recommendation 11, para 10.25, Chapter 10 Senate Inquiry Report
- 25 See Treasury, June 2007, *Financial Reporting by Unlisted Public Companies Discussion Paper*, <<http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1269>> [30 January 2009]. See also PilchConnect submission to this review at <<http://www.pilch.org.au/Assets/Files/Unlisted%20companies%20review.pdf>> [30 January 2009]
- 26 See also comments by Professor Myles McGregor-Lowndes, p 44 Senate Hansard, 29 October 2008: <<http://www.aph.gov.au/hansard/senate/commttee/S11330.pdf>> [30 January 2009]
- 27 Senate Hansard, 29 October 2008, pp 83–89: <<http://www.aph.gov.au/hansard/senate/commttee/S11330.pdf>> [30 January 2009]
- 28 Senate Hansard, 29 October 2008, p 89: <<http://www.aph.gov.au/hansard/senate/commttee/S11532.pdf>> [30 January 2009]
- 29 See evidence by Sue Woodward, Manager PilchConnect Senate Hansard, 11 November 2008, p 5 available at <<http://www.aph.gov.au/hansard/senate/commttee>> [30 January 2009]
- 30 For example Allens Consulting Group, 2005, note 8
- 31 See ATO submission to Inquiry into the Definition of Charities and Related Organisations (2001) available at: <<http://www.cdi.gov.au>> [30 January 2009]
- 32 See paras 5.42 to 5.44, Senate Inquiry Report
- 33 See para 5.36, Senate Inquiry Report
- 34 See para 6.29, Senate Inquiry Report
- 35 ABS 2001 op cit, note 5 <www.abs.gov.au/AUSSTATS/abs@nsf/productsbyCatalogue/A41A434D8A63A4DCCA256C7E0076ABE2?OpenDocument>
- 36 Para 10.34, Senate Inquiry Report
- 37 See recommendation 12, para 10.51 Senate Inquiry Report ●