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Review of Australian Charities and Not-for-Profits Commission Legislation

Introduction

The Institute of Public Accountants (IPA) welcomes the opportunity to offer our submission on 'Review of Australian Charities and Not-for-Profits Commission Legislation'.

The IPA is one of the three professional accounting bodies in Australia, representing over 35,000 accountants, business advisers, academics and students throughout Australia and internationally. The IPA prides itself in not only representing the interests of accountants but also small business and their advisors. The IPA was first established (in another name) in 1923.

The IPA's submission has been prepared with the assistance of the IPA-Deakin SME Research Centre. We are grateful for their contribution and guidance. We note that Su McCluskey is a member of the advisory panel for the Research Centre, however, she has had no involvement in the preparation of this submission.

The IPA submission also benefits from consultations with IPA members who from time-to-time, articulate their views and concerns on a variety of matters. We are also grateful to all those who have taken the time to provide their input to the many government submissions the IPA has prepared as part of their advocacy role on behalf of the membership.

We look forward to discussing further and in more detail the IPA's recommendations with the Government and Treasury. Please address all further enquires to Vicki Stylianou at either vicki.stylianou@publicaccountants.org.au or 0419 942 733.

Yours faithfully

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Dear Sir

Review of Australian Charities and Not-for-profits Commission (ACNC) Legislation

The Institute of Public Accountants (IPA) welcomes the opportunity to offer our perspective on the Review of Australian Charities and Not-for-profits Commission (ACNC) legislation. The IPA has members that work with charities and associations who are affected by the work of the ACNC. This submission is informed by the views of IPA members as discussed with us from time to time as well as extensive research conducted by the IPA-Deakin SME Research Centre.

The review of the legislation comes after five years of operation. The IPA supports the periodic review of legislation to ensure that the law is evaluated and revised where necessary to meet contemporary social and regulatory requirements. It is a review that also coincides with a review by other government agencies of reporting requirements for charities. The work being undertaken by the Australian Accounting Standards Board (AASB) and the Auditing and Assurance Standards Board (AUASB), for example, on the simplification of reporting requirements for charities which is further discussed below.

The ACNC has played an important role in regulating the not-for-profit sector, which, as observed by Johansson (2017), is made up of approximately 600,000 NFPs (Productivity Commission, 2010). Moreover, in 2012-13 NFPs contributed to over 4% of GDP, employed over 1 million Australians and attracted 3.9 million volunteers (Australian Bureau of Statistics, 2015). NFP entities have predominantly been concerned with charities. These entities are economically significant and merit strong regulation that is proportionate to the size and resources controlled by the entity. The ACNC achieves this regulatory regime as a part of its objectives as set out under the principal ACNC Act 2012. However, the IPA is concerned that the Act has a broader remit, which the ACNC is unable to properly fulfil given the fragmented regulatory framework existing in Australia for not-for-profit entities.

A review of the current legislation and its adequacy cannot be fully undertaken without a broader analysis by the Commonwealth and State and Territory governments of all regulations impacting not-for-profit entities. The ultimate policy outcomes should be the referral of legislative powers related to the regulation of incorporated associations and similar bodies from the States and Territories to the Commonwealth. Such a reform would ensure that the same compliance requirements apply to incorporated associations across the country.

Increasing use of information technology by government agencies means that the merger of a range of registries maintained by State and Territory governments is possible. The Australian Securities and Investments Commission (ASIC) has, for some years, housed the business name

registers that were previously kept by registrars in each state. The establishment of the national register required the cooperation of States and Territories and the same kind of proactivity would be critical if referral of the power to register and regulate incorporated association proceeds. Changes in information technology also make it easier for not-for-profit organisations to lodge documentation with regulators using online portals rather than paper-based lodgements.

Transitioning to a national regime of registering associations may also make it easier for securities and intelligence agencies to monitor various charities and not-for-profits that match the characteristics of not-for-profit entities that may be involved in financing terror organisations (AUSTRAC-ACNC 2017).[1] Bringing entities under one umbrella means there is only one set of contemporary data that needs to be investigated by security agencies rather than needing to seek access to multiple databases around the country. One point of registration, monitoring and regulation would provide security, intelligence and law enforcement agencies, with a single source of information on which to draw on and review.

It is acknowledged that there will be not-for-profit organisations such as unincorporated associations or trusts that may not fall within the scope of any regulatory regime at a Commonwealth, State or Territory level, except where they conduct a regulated activity such as the operation of a charity. This limitation of scope should not be considered as a basis to set aside the concept of creating one comprehensive regulatory regime of not-for-profit organisations in Australia.

Types of not-for-profit bodies in Australia

Not-for-profit bodies such as charities, associations supporting specific causes or sporting clubs take several different forms in Australia. At the most basic level, a not-for-profit organisation can take the form of an unincorporated association (Sievers 1989; Sievers 2010). The governance of such a not-for-profit body will normally be regulated by a constitution and by-laws made by a management group defined in the constitution. As a general observation, these entities are unregulated by a government body unless they have another purpose such as a political party or a trade union. A political party will need to register and comply with electoral laws if it wishes to receive public funding for contesting elections with candidates standing in their name. A trade union must be registered with the Fair Work Commission in order to appear before the Commission in wage cases or matters of industrial disputation. Unincorporated bodies that do not operate within a regulated regime are accountable only to their members, but the absence of incorporation may create legal risks for members as there is no corporate structure that can enter into legal contracts, conduct business or take legal action.

[1] AUSTRAC has published characteristics that could lead to organisations being vulnerable to money laundering and terrorist financing. These characteristics are used as a part of assessing which entities might be at greatest risk. AUSTRAC also cooperates with countries in the Asian region in endeavouring to obtain a comprehensive assessment of terror financing and money laundering practices impacting not-for-profit entities.

Incorporated associations, which are a cost-effective manner of incorporating an organisation, are regulated at a State or Territory level with each jurisdiction having a separate agency and regulatory regime dealing with these bodies (Sievers 2010). Not-for-profit entities can also take the form of public companies limited by guarantee at a Commonwealth level. Challenges posed by the current compliance and reporting regimes for entities obligated to comply are outlined below. It should also be noted that charities and not-for-profit organisations may also take the form of trusts or foundations.

Legislated objectives of the ACNC

The ACNC was established in 2012 as a way of better regulating the charitable and not-for-profit sector by introducing a greater level of transparency to existing and potential donors to charities and not-for-profits operating in Australia. While the ACNC has worked toward eliminating duplication, recent research reports and discussion papers issued by the AASB (2017), note that multiple regimes with multiple regulators and different reporting and audit requirements create an inefficient and confusing, and sub-optimal regulatory environment. The multiple regulatory regimes create a structural obstacle for the ACNC in achieving the principal objectives set down in the ACNC Act. The objectives set down in Division 15 of the Act are:

a) to maintain, protect and enhance public trust and confidence in the Australian not-for-profit sector;
b) to support and sustain a robust, vibrant, independent and innovative Australian not-for-profit sector; and
c) to promote the reduction of unnecessary regulatory obligations on the Australian not-for-profit sector.

The legislation also provides for the ACNC Commissioner to cooperate with other relevant government agencies in order to oversee a simpler regulatory framework for not-for-profit entities. There is also a role for the ACNC Commissioner to educate the public in regard to the work of the not-for-profit sector as well as supporting the sector's transparency and accountability obligations.

Only those organisations registered with the ACNC are subject to its oversight and the legislation creates an incentive for entities to register. Not-for-profits such as charities will be ineligible for certain tax concessions if they are unregistered with the regulator. The law also provides that registration could be a prerequisite for any other exemptions, benefits and concessions that may exist in law for entities.

A single reporting regime for charities and not-for-profits

The financial reporting requirements for charities and not-for-profit entities across Australia are varied and complex with a recent research report published by the AASB (2017) observing that Australia's regime for charity reporting is the most complex when compared with seven other jurisdictions surveyed. The other countries examined as a part of this exercise were New Zealand, United Kingdom, Hong Kong, Singapore, South Africa and Canada. The report from the standard setter states that the jurisdictions reviewed by the research project team

had a 'clearer, less onerous financial reporting framework'. One of the pre-eminent features noted in the report was that the regulators in the six offshore jurisdictions reviewed, prescribed the actual format the financial reports that needed to be lodged rather than the entities themselves being in a position to self-assess.

The risk in the current Australian regime, that is, being able to self-assess and nominate a format appropriate to the circumstances of the entity, will result in a lack of uniformity and an absence of comparability in the sector (AASB 2017). The question of self-assessment particularly in this sense, relates to whether a registered entity prepares *special purpose or general purpose* financial reports. The ability for those in charge of governance of an entity to choose between a special purpose or a general purpose financial report is linked directly to the determination of whether an entity is a reporting entity as defined by the Statements of Accounting Concepts developed by the Australian Accounting Research Foundation (AARF 1990, AARF 1997). Reporting entities are defined as 'entities in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reporting for information which will be useful to them for making and evaluating decisions on the allocation of scarce resources' (McCahey et al 1989). The underlying objective of the reporting entity concept (Ball 1988, McCahey et al 1989, AARF 1990 1997, Langfield-Smith 1991, Walker 2007, Carey et al 2014) was to simplify the determination by preparers of the kind of financial reports they needed to produce and which entities needed to prepare a general purpose financial report prepared in accordance with all accounting standards. McCahey et al (1989) outlined the key features of the policy intended to resolve any concerns as to the application of the reporting entity concept within the (then) relevant accounting framework, that is, whether an entity needed to prepare special purpose or general purpose financial reports. The discussion paper recommended the following:

1. Certain types of entities will always meet the criteria for identification as reporting entities, for example, listed companies and listed trusts, and thus should automatically prepare general purpose financial reports;
2. Certain types of entities are unlikely to meet the criteria for identification as reporting entities, for example, exempt proprietary companies and privately-owned trusts, and thus are unlikely to be required to prepare general purpose financial reports, but it is impossible to deem that all such entities, on all occasions are not reporting entities (unless specific provisions within their constitutional documents and deeds expressly require the preparation of general purpose reports);
3. Entities which prepare, either because the criteria for identification as a reporting entity are met or for some other reason, financial reports which are intended to be general purpose in nature must comply with all Statements of Accounting Concepts and Statements of Accounting Standards in the preparation of those reports;
4. An unqualified audit opinion is available only in respect of general purpose financial reports; and
5. There are other requirements to prepare a general purpose financial report that can be enforced by ASIC in certain circumstances, however, not regarded by the IPA to be within the scope of the current submission.

The discussion paper provided further impetus to the development of the concept statements (AARF 1990, 1997) that led to the notion that a reporting entity must prepare general purpose financial statements. Conversely, an entity that was not defined as a reporting entity would not be required to prepare financial statements. While the concept itself is sound, the application of the reporting entity concept in practice has been varied and has produced inconsistencies in the reporting to regulators by entities (Carey et al., 2014). The AASB itself has sought to slightly modify the reporting requirements for reporting entities so that a reduced disclosure regime operated for those entities in which there is no public interest (Potter et al 2013), but reporting entities are still required to comply with recognition and measurement criteria contained within several accounting standards. Following these themes in respect to not-for-profits, the AASB has noted that there may be a risk of non-compliance given that small charities may choose not to engage an accounting firm or an expert to help compile financial information and to present that material in accordance with accounting standards (AASB 2017).

The AASB Research Report (2017) further states that the following factors create a more complex environment for charities required to comply with registration and reporting obligations in Australia:

- Multiple regulators: The report notes that there are state-based regulators and also the ACNC that oversee charities, which number around ten regulatory agencies in all, whereas Australia's near neighbour, New Zealand, has only one regulator for the entire sector. There are also areas of duplication between regulators and it is noted that charities experience some difficulty in determining what they should be reporting and to which regulatory authority (AASB 2017).

- Variations in requirements between jurisdictions: There are differences between State and Territory reporting thresholds that result in confusion. The ACNC, for example, uses total revenue in determining "whether an entity holds a gaming machine licence as proxies for the significance of incorporated associations" whereas the Northern Territory uses annual gross receipts, and gross assets. (AASB 2017). Similar measurement criteria might exist across some jurisdictions but minimum thresholds may differ. There are also different consequences of exceeding thresholds in different jurisdictions.

- Financial report formats are open to significant judgement: Charities are often required to use judgement to determine the type and contents of financial statements.

- The rationale for rules are unclear: The ASSB Report (2017) states that there is no apparent reason for certain requirements embedded in the law of various jurisdictions. The report also notes that Queensland has reporting requirements for co-operatives that differ from other states. Of more concern perhaps is that the report observes that there appears to be no focus on *user needs* in financial reporting requirements or how information could be displayed in a manner that helps charities explain their purpose, operations and performance. Entities could be spending time preparing and having audited information that is too complex and irrelevant to their stakeholders.

- Audit requirements vary depending on jurisdictions: There are differences between circumstances when an audit or review may be required and also the qualifications of an individual deemed to be appropriate to conduct an audit of a charity. This creates additional confusion for both charities and accounting professionals when seeking to comply with the rules of Federal, State or Territory governments as they relate to charities.

These factors are a strong indication that there is need for further work to be done by the Commonwealth, State and Territory governments to ensure that powers are referred where necessary to the Federal Government. As previously mentioned, this one way of ensuring that all charities and not-for-profits are subject to consistent requirements across the country. A move to have a prescribed format for charity financial reports as well as the elimination of differences across jurisdictions in laws and regulations in Australia, would not only simplify and clarify the compliance requirements for charities, but would provide a consistent and comparable set of financial statements more suited to the needs of users and other relevant stakeholders. These initiatives will also ensure that practitioners providing services such as financial report preparation or audit and assurance services, for example, have a less complex task in explaining requirements to clients and fulfilling engagement-related obligations. While the IPA supports a 'prescribed format approach in the preparation of financial statements, it is important to for the AASB to ensure, however, that any set format and accompanying accounting guidance produced for a prescriptive regime, remains faithful to recognition and measurement requirements of the accounting standards.

It should also be noted that many charities have moved voluntarily to report additional information relating to their overall performance, notwithstanding that there have not been any mandatory requirements for the provision of such information. Research recently conducted by Johansson (2017) has demonstrated charities that provide more information to donors and potential donors are more likely to increase market share of donations in the following year. While the IPA supports a move towards more standardised or pro forma reporting the scope for entities to provide more information should be emphasised and encouraged. Johansson's research suggests that the market will reward charities that are perceived as being more transparent than other similar organisations. These findings are consistent with a significant body of literature supporting the positive reputational effect of voluntary disclosures (Deegan, 2014). This phenomenon, can in effect, be likened to *legitimacy theory* which posits that entities have an implied social contract with society and in satisfying the terms of that contract will seek to legitimise their operations within the community by disclosing volumes of non-mandatory information (Deegan, 2014). On balance, these initiatives would lend support to the urgent need for greater transparency, particularly in the case of not-for-profits, that compared with profit making entities, have appeared to avoid public scrutiny given their charitable and altruistic endeavours. As Deegan (2014) also explains, the danger with voluntary information is that it tends to be 'positive' centric, that is, more good news is disclosed than bad news, for obvious reasons. Moreover, voluntary information is not subject to normal audit processes and thus the value of the information in terms of accuracy and more importantly, the usefulness to users, could be called into question. Given the above arguments, while the IPA supports voluntary disclosures that reflect the activities and operations of charities, the AASB may need to have guidelines and

mechanisms in place to ensure the additional information is relevant, reliable and representational.

Audit consequences of creating a single regime for the regulation of not-for-profit entities

The IPA notes that a single national regime will mean that one set of criteria for the review or audit of not-for-profit entities will need to apply. This will streamline the legislative requirements for the audit or review of not-for-profit entities and provide clarity to practitioners in terms of whether they meet the requirements (or what further requirements are needed) to be eligible to undertake an audit of not-for-profit entities. The IPA encourages the Federal Government to work with the professional accounting bodies and the AUASB to ensure a seamless transition from multiple regulatory regimes to a single national regulator.

Transparency and financial statements

A key feature of the ACNC regulatory regime is the transparency of financial information that is lodged by registrants as one part of their compliance with their legal obligations. These financial statements are freely accessible by all interested stakeholders as a part of the regulatory regime that ACNC administers. The financial statements provide information about the financial position, financial performance and narrative disclosures about the activities of an entity on an annual basis so that current and potential donors, current and potential volunteers, regulators and other stakeholders are able to use this information for decision making purposes. A registered entity is able to receive grants and benefits such as special tax treatment, similarly donors are able to receive tax deductions for donations where an entity satisfies the extensive requirements within tax legislation. Indeed satisfying the requirements of the ACNC Act, including the publication of governance information including annual reports is a prerequisite to accessing the additional benefits, including grants and tax concessions.

Free access to the financial statements of other not-for-profit organisations is not readily obtained by interested stakeholders where the financial statements are only accessible via the payment of a fee to the relevant agency. The state is the agent for the broader community in collecting the information, but individuals seeking access must pay to view that information collected on their behalf. The IPA believes that the time has come to reflect on whether access to the information collected by ASIC, for example, ought to be freely available to the general community in the same way as this information is freely available on the ACNC website, given that the underlying purpose of all legislation is consideration of the public interest. If the latter is found to be common ground between the ACNC and ASIC in this review of the ACNC legislation, then it is difficult to sustain an objection to allowing free access to registers maintained by government bodies. Such access is critical for research undertaken by public policy think tanks and academics at universities and the freeing up of access would greatly help on that front.

Researchers and stakeholders require access to corporate records in order to conduct empirical research or investigations for journalistic or legal purposes. The cost of accessing these records is prohibitive and begs a fundamental question: why are people paying for records that are kept in the public interest? The financial statements and other company

details should be freely available given that the information is being collected for the public interest. It appears incongruous that members of the public interested in viewing the information need to pay for reports and other lodgements when in fact companies must, as a price for getting to use the veil of incorporation, supply the publicly-funded regulator with financial and other reports. The current review by Federal Treasury of the way in which registers are created and operated across all Commonwealth departments is an ideal opportunity to create a system where financial statements lodged with the corporate regulator are made freely available to all interested parties.

Registrars for incorporated associations in individual States and Territories also charge for access to information such as annual reports. One of the outcomes of the referral of powers to register and regulate incorporated associations to the Commonwealth could be free access to this information if the ACNC's practice of publishing financial statements online and providing free access is followed.

Not-for-profits and terror financing

Redesigning the national regulatory regime so that there is one comprehensive reporting and compliance regime for charities and not-for-profits could make it more efficient for national security, intelligence and enforcement agencies to investigate suspecting terror financing or money laundering activity. It is acknowledged by regulatory authorities worldwide that one means terrorist groups use to access finance is through the diversion of funds to terror organisations from charitable bodies. Gurule (2008) observes that witting and unwitting donors to a range of charities across the Gulf States for example, provided financing for groups such as al Qaeda and HAMAS. Australian regulators and law enforcers have held similar concerns about charities operating in Australia. The ACNC and AUSTRAC's (2017) recent review of the overall risk of money laundering and terror financing in Australia suggests that such activities occur on a frequent basis through not-for-profit organisations. The ACNC-AUSTRAC analysis, which was conducted on the population of Australian charities, indicates that the threat of money laundering and terrorist financing via not-for-profits is moderate. The ACNC-AUSTRAC report states that this medium-level threat of money laundering and terrorism financing is primarily based on suspicious items (matters) being reported, the number of investigations involving not-for-profit entities, and anecdotal information from individuals working within the not-for-profit sector (ACNC-AUSTRAC 2017).

The report also notes that there are a series of factors that may make not-for-profits such as charities vulnerable to money laundering and terrorism financing. These factors are:

- poor understanding of the risks of money laundering and terrorism financing,
- poor due diligence on key personnel, volunteers, partners and beneficiaries,
- inexperienced staff,
- lack of formalised training and ongoing professional development,
- poor record keeping,
- weak internal controls, poor transparency and accountability of the end-to-end funding cycle,
- beneficiaries or operations in countries with poor AML/CTF regimes,

- beneficiaries or operations in conflict or post-conflict regions, and
- beneficiaries or operations in dispersed ethnic communities in Australia, with strong links to high risk countries (specific to terrorism financing only).

Some of these matters are able to be dealt with in the monitoring of governance standards by the ACNC. Other factors may require the involvement of AUSTRAC and security intelligence authorities to monitor money flows from Australian not-for-profit organisations to other bodies overseas. Monitoring of these organisations, which includes access to various reports and materials held by regulators such as the ACNC, would be more efficient if a single regulatory regime for not-for-profit organisations operated at a national level. IPA has been and will continue to be involved in the consultation being undertaken by the Attorney-General's Department on the revision of the anti-money laundering legislation and regulation.

Areas requiring further research in the not-for-profit sector

While the IPA acknowledges that the current review of the ACNC legislation is limited to the registration and ongoing regulation of charities and not-for-profits, there are other areas of association regulation that merit further investigation. Further research will inform future considerations in the area of regulation in this sector. For example, a vast number of not-for-profit organisations are incorporated or unincorporated associations (Johansson 2017) and as such further research focused on whether differences between organisational structures and regulatory regimes impacts on the reporting practices engaged in by entities. Such research, Johansson (2017) observes, could include a classification of members into different categories and exploring the presence of different types of members in relation to governance schemes. A further area of research suggested by Johansson (2017) is related to whether regulatory changes, members and proprietary costs affect the quality of the financial and non-financial disclosures by charities. There is also scope for further research into the volume and quality of information that charities release in documents or other forms outside of financial statements. This type of research is important because it would help establish how charities and similar organisations communicate with their stakeholders.

It is noted that there are entities operating as unincorporated associations, which are also mentioned by Johansson (2017), that will not be subject to regulatory oversight except in circumstances where they are entities such as political parties or trade unions The IPA considers that there is merit in further examining the quality of reporting of bodies such as trade unions to better understand how reporting regulations are applied. There may be merit in broadening the application of the work being done by the AASB and AUASB on streamlining the reporting of charitable organisations to other bodies that are required to lodge annual statements and financial reports with regulatory bodies. The goal of financial reporting overall is similar and it is worthwhile considering whether any reporting regime designed for charities could fulfil the accountability objectives in other areas of regulation overseen by Federal, State and Territory government departments.

Additional research in this area must be undertaken so that the financial reporting framework embedded in law for associations and charities, requires these entities to disclose key information about their financial position, financial performance and the non-

financial narrative explaining achievements or objectives of the organisation concerned.

Other matters

The IPA commends the consultative process adopted by the ACNC in a range of areas including but not limited to the work the Commission has been undertaking on the development of a chart of accounts for not-for-profits. The IPA appreciates the ACNC's willingness to work with the IPA and other stakeholders to develop a standardised chart of accounts that makes the maintenance of governance and financial records simpler for smaller organisations.

Recommendations

- The current objectives of the ACNC legislation remain valid, but a single national regulatory regime for registered not-for-profit entities would assist the ACNC to better meet its overall objectives.
- The Federal, State and Territory Governments should agree to pursue a single, national regulatory regime for incorporated associations so that there is a single national register for these entities.
- Information about the governance arrangements and financial performance of all not-for-profits subject to the regulation under a single regime should be freely accessible in the same manner as they currently are under the ACNC regime.
- The Federal Government should support the work of the AAASB and AUASB in the development of a tailored reporting regime for charities and not-for-profits.
- The Federal Government should work with all stakeholders to ensure a smooth transition from a fragmented regulatory approach to a more holistic regime for not-for-profit regulation.
- The Federal Government should consider funding further research into the governance and financial reporting practices of not-for-profit entities. Such research should include the practices engaged in by not-for-profits that are regulated in other legislated regimes.

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