

# Scoping study for a national not-for-profit regulator

Consultation Paper  
January 2011

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# CONTENTS

- CONSULTATION PROCESS ..... III**
  - Request for feedback and comments ..... v
- FOREWORD ..... VII**
- SCOPING STUDY FOR A NATIONAL NOT-FOR-PROFIT REGULATOR..... 1**
  - Stakeholder consultation .....1
  - Background.....1
  - Previous reviews and inquiries .....3
  - The current regulatory environment.....6
  - The role and responsibilities of a national NFP regulator .....7
  - Sector specific regulation of the NFP sector .....23
  - Funding implications .....24
  - Definitional issues .....25
- APPENDIX A — REGULATORY MODELS ..... 28**
  - NFP regulation in England and Wales .....28
  - NFP regulation in Northern Ireland.....29
  - NFP regulation in Scotland .....29
  - NFP regulation in New Zealand .....30
  - NFP regulation in Ireland.....31
  - NFP regulation in the United States .....32
  - NFP regulation in Canada .....33
  - Endnotes .....35



## CONSULTATION PROCESS

### REQUEST FOR FEEDBACK AND COMMENTS

All submissions received will be treated as public documents unless the author of the submission clearly indicates the contrary by marking all or part of the submission as 'confidential' prior to the submission being lodged. Public submissions may be published in full on the Treasury website, including any personal information of authors and/or other third parties contained in the submission. If your submission contains the personal information of any third party individuals, please indicate on the cover of your submission if they have not consented to the publication of their information.

A request made under the *Freedom of Information Act 1982* for access to a submission marked confidential will be determined in accordance with that Act.

**Any proposals outlined in this paper have not received Government approval. The document does not represent Government views nor put forward a final Government position. This paper merely provides discussion of policy options in order to begin a consultation process with stakeholders which will inform future policy direction.**

### Closing date for submissions: 25 February 2011

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## FOREWORD



I am very pleased to release this consultation paper as part of the scoping study for a national not-for-profit (NFP) regulator.

The release of the paper marks the beginning of an eagerly awaited reform process that will deliver smarter regulation, reduce red tape and improve the transparency and accountability of the NFP sector.

The importance of this valuable sector cannot be ignored. Without the work of Australia's 600,000 NFPs, many of our most disadvantaged and vulnerable citizens would not be able to access the vital services that they require.

The consultation paper forms part of the Government's 2010 election commitment to strengthen the NFP sector. The paper seeks comment from stakeholders on the goals of national regulation, the scope of national regulation and the functions and form of a national regulator.

The Government is committed to consulting with stakeholders, including the states and territories, at every stage of the reform process, and I look forward to receiving the community's views on these important issues.

**The Hon Bill Shorten MP**  
**Assistant Treasurer and Minister for Financial Services and Superannuation**



# SCOPING STUDY FOR A NATIONAL NOT-FOR-PROFIT REGULATOR

## STAKEHOLDER CONSULTATION

1. This paper seeks initial views in relation to design options for a national NFP regulator. It does not seek to address issues which have previously been examined by recent reviews and inquiries.
2. During the 2010 election campaign the Government outlined its commitment to reform Australia's NFP sector to deliver smarter regulation, reduce red-tape and improve the transparency and accountability of the sector.
3. The Government has tasked Treasury with undertaking a scoping study to determine the role, functions, feasibility and design options for a 'one-stop shop' NFP regulator.
4. The paper discusses the features of a best practice regulatory framework and also seeks stakeholder views in relation to:
  - the goals of national regulation;
  - the scope of national regulation;
  - the functions of a national regulator; and
  - the form of a national regulator.
5. The paper seeks input from stakeholders on these issues in order to inform the design of a national regulator. The consultation process will also help guide future reform direction.
6. The Government is committed to consulting with stakeholders, including the states and territories, at every stage of the reform process.
7. Following this scoping study, further consultations on any implementation of a national NFP regulator will be undertaken with stakeholders. Specific sectors or types of NFPs, detailed regulatory reform, transitional arrangements and administrative issues may be the subject of additional consultation.

## BACKGROUND

8. The NFP sector broadly consists of organisations which seek to achieve a community, altruistic or philanthropic purpose, and who are involved in the supply of goods and services that have a social value greater than the price that a consumer could or would otherwise pay. The NFP sector can also be defined in broad terms, as encompassing all those in the economy who are not households, government or businesses that operate for-profit.<sup>1</sup>
9. The NFP sector is characterised by its diversity, with entities ranging from micro-sized sporting and recreational clubs to large national and multinational charitable organisations. The sector consists of approximately 600,000 entities,<sup>2</sup> and contributes around \$43 billion to GDP per annum.<sup>3</sup>

10. NFPs deliver services to their members, their clients or to the wider community such as through the provision of welfare, education, sports, arts, worship, culture and community services.<sup>4</sup> Through providing opportunities that promote self-connection and influence, the sector lays the foundations for an active civil society.<sup>5</sup>
11. The NFP sector is growing in size and importance to the Australian economy. The NFP sector grew at an average rate of 7.7 per cent per annum in the period from 1999-2000 to 2006-07.<sup>6</sup> This is partly due to the growing trend for governments to contract with NFP entities to undertake service delivery. This has significantly changed the way the sector is funded, and the related requirements to better manage risk and return have resulted in a need to improve the simplicity and transparency of regulatory arrangements for the NFP sector.
12. In addition to its growing economic role, the sector also makes a significant contribution to the wellbeing of Australians. The 2010 Productivity Commission report on the *Contribution of the Not-for-Profit Sector* (PC Report) noted four broad ways that NFPs contribute to community wellbeing: through service delivery and concomitant opportunities for participation; by exerting influence on economic, social, cultural and environmental issues; through connecting the community and expanding social networks; and by enhancing community endowment through skills and asset investment.<sup>7</sup> Given the importance of these benefits to both current and future generations of Australians, it is vitally important that the sector is regulated so that it remains accountable to the communities it serves.
13. In recognition of the vital economic and social role it plays, the Government provides significant support to the sector. Government funding to the sector in 2006-07 was \$25.5 billion.<sup>8</sup> Overall government funding has grown from 30.2 per cent of sector income in 1999-2000 to 33.2 per cent in 2006-07.<sup>9</sup>
  - 13.1. Governments provide funding to the sector to pay for the sector's delivery of programs and services on behalf of governments. For example, the Australian Government provides \$444 million through the Family Relationship Services Program to NFPs to provide family services such as counselling.
  - 13.2. Substantial funding is provided to the NFP sector through Government expenditure on education, for example, non-government schools were provided \$14.9 billion in 2008,<sup>10</sup> and Higher Education Providers were provided \$11.4 billion in 2009.<sup>11</sup>
14. Total philanthropic donations to the sector reached \$7.2 billion in 2006-07<sup>12</sup> and an estimated value of \$14.6 billion was provided in volunteer time.<sup>13</sup>
15. In addition, the Australian Government and State and Territory governments provide a range of generous tax concessions to eligible NFP organisations, including: an income tax exemption; deductible gift recipient (DGR) status; refundable franking credits; and fringe benefits tax, goods and services tax (GST), land tax, payroll tax and municipal rates concessions.
  - 15.1. Philanthropic gifts claimed as tax deductions have increased each year since 1992, rising also as a proportion of GDP. In the ten years to 2007-08, donations claimed by individuals increased by an average annual rate of 14.4 per cent to reach \$2.34 billion,<sup>14</sup> with claims in 2007-08 estimated to have reduced tax revenue by \$810 million.<sup>15</sup> Donations to private ancillary funds, an intermediary to the NFP sector, resulted in an estimated cost to revenue of \$210 million in 2007-08.<sup>16</sup> Refundable franking credits to NFPs have also risen significantly from 2001-02 to 2008-09, from \$93 million to \$554 million per annum.<sup>17</sup>

- 15.2. The growth in tax expenditures needs to be considered against average annual nominal non-farm GDP growth over the ten years to 2009-10 which was 6.9 per cent,<sup>18</sup> and average annual tax revenue growth over the same ten years was 5.7 per cent.<sup>19</sup>
- 15.2.1. Total quantifiable Commonwealth tax expenditures provided to the NFP sector in 2010-11 were estimated to be in the order of \$3.7 billion.<sup>20</sup> Unquantifiable tax expenditures to the sector are likely to be of similar magnitude. For example, the *2009 Tax Expenditures Statement* states that the income tax exemption for charities is unquantifiable but estimated to be in excess of \$1 billion per annum.
- 15.2.2. State tax expenditures to the sector, which not all states publish, are also substantial. For example, Victoria's tax expenditures to the NFP sector were estimated to be in the magnitude of \$759 million in 2009-10.<sup>21</sup>
16. These taxation concessions are provided by Government because it values the contribution the sector makes to the welfare of the wider Australian community. Given that these concessions are taxpayer funded and thus NFPs are in receipt of taxpayer monies, there needs to be a high degree of accountability flowing back to the public. Reporting is one such accountability measure that could be improved.
17. Current reporting requirements across the sector are inconsistent as there is minimal reporting for some organisations and excessive reporting for others. In addition, there is limited easily accessible information available to the public on the activities of entities. The current lack of information available to the public acts as a barrier to the optimal allocation of resources, thus undermining philanthropic engagement and potentially the generosity of donors.
18. While improved accountability measures could enhance public trust, confidence and engagement in the sector, the regulatory framework too needs improvement as its complexity is placing an unnecessary burden and high compliance costs on NFP entities. The current regulatory environment for the NFP sector is often inconsistent, overlapping and complex and is thus in need of simplification. By reducing the regulatory burden on NFPs, the sector can concentrate its efforts on what it does best — delivering services to the community.
19. While recent trends have seen higher levels of governance and accountability required of both the for-profit and government sectors, trends to improve governance and accountability have not extended to the regulation of the NFP sector. Given the gains to be made through increased community engagement and reducing the regulatory burden, there are sound reasons for governance and accountability reforms.

## PREVIOUS REVIEWS AND INQUIRIES

20. There have been several reviews into the regulation and taxation of the NFP sector in Australia over the last 15 years. The sector has largely supported the recommendations made by these reviews and is calling for prompt Government action and implementation of a reform agenda.
21. A consistent theme has emerged from these reviews that the regulation of the NFP sector should be significantly improved by establishing a national regulator and harmonising and simplifying regulatory and taxation arrangements.
22. The 2001 Report of the inquiry into the *Definition of Charities and Related Organisations* recommended consideration of the establishment of a comprehensive national administrative framework for the charitable and related sector and an independent administrative body for charities and related entities.

23. The 2008 Senate Economics Committee inquiry into *Disclosure Regimes for Charities and NFP Organisations* recommended the establishment of a single independent national regulator for NFP organisations.
- 23.1. The Committee further recommended that the national regulator should have similar functions to regulators overseas. The Committee proposed a broad role for the NFP regulator, including:
- registering NFP organisations;
  - educating the sector and encouraging compliance;
  - educating the public about the role of NFP organisations; and
  - developing and maintaining an accessible, searchable public information portal.
24. The review into *Australia's Future Tax System* (AFTS review) recommended that a national charities commission should be established to monitor, regulate and provide advice to all NFP organisations.
- 24.1. The AFTS review recommended that a charities commission should also be tasked with streamlining the NFP tax concessions (including the application process for gift deductibility), and modernising and codifying the definition of a charity.
25. The PC Report recommended the establishment of a 'one-stop shop' for Commonwealth regulation by consolidating various regulatory functions into a new national registrar. The Commission further recommended that while ultimately the registrar could be an independent statutory body, it should initially be established as a statutory body corporate or organ within the Australian Securities and Investment Commission (ASIC).
- 25.1. The PC Report recommended that the regulator undertake a variety of functions including:
- assessing the eligibility of NFP organisations for Commonwealth tax concession status;
  - endorsing and maintaining a register of endorsed organisations;
  - registering and regulating NFP companies limited by guarantee;
  - providing a single reporting portal for corporate and financial information; and
  - investigating compliance with regulatory requirements.
26. The 2010 Senate Economic Legislation Committee inquiry into the Tax Laws Amendment (Public Benefit Test) Bill 2010 recommended the establishment of a single independent national commission for NFP organisations.
- 26.1. The Committee recommended that the regulator undertake a broad range of activities including:
- promoting public trust and confidence in the charitable sector;
  - encouraging and promoting the effective use of charitable resources;

- developing and maintaining an accessible, searchable public interface;
- processing annual returns submitted by charitable entities;
- monitoring charitable entities and their activities to ensure that registered entities continue to be qualified; and
- monitoring and promoting compliance with relevant legislation.

## International developments

27. There has also been significant reform of the regulation of the NFP sector internationally over the last decade (see Appendix A).
28. Countries which are federations, similar to Australia, have tended to set up regulators within their tax authorities.
- 28.1. In Canada, the Canada Revenue Agency (CRA) is Canada's federal agency responsible for administering the taxation law. The Charities Directorate is a structurally separate area of the CRA which is responsible for administering the law in relation to registered charities and certain other 'qualified donees'. The role of the Charities Directorate includes:
- reviewing applications for registration;
  - providing guidance on maintaining registered status;
  - ensuring that organisations comply with requirements; and
  - providing information and education programs for the charitable sector and for donors.
- 28.2. In the United States (US), the Internal Revenue Service (IRS) is responsible for the registration of tax-exempt organisations. The role of the IRS is to: consider whether an organisation meets the requirements for tax exemption; assist tax-exempt organisations with their tax law responsibilities; and improve compliance. Charitable organisations must also make available their annual business income returns for public inspection.
29. In non-federal countries a separate regulator has generally been formed.
- 29.1. In the United Kingdom (UK), the Charity Commission has been established as the independent regulator of charities in England and Wales. The role of the Charity Commission includes:
- providing advice and guidance to registered charities;
  - ensuring that charities are accountable and meet their legal obligations;
  - identifying and investigating abuse and mismanagement through compliance activities; and
  - maintaining an online register of charities which records details of registered charities in England and Wales with information provided from annual returns or updates.

- 29.2. The Charity Commission for Northern Ireland has been established as the regulator of charities in Northern Ireland, and will soon start registering charities in Northern Ireland. Charities will be able to use an online register of charities to update information that is held on the charity and allows for the submission of annual returns, trustees' annual reports and accounts.
- 29.3. The Office of the Scottish Charity Regulator determines whether bodies are charitable, maintains a public register, facilitates and monitors compliance by charities and investigates and takes remedial action in the case of misconduct by charities.
- 29.4. The New Zealand charities regulator, the Charities Commission, was established in 2005. Its role includes:
- registering charities;
  - providing education in relation to good governance;
  - collecting annual returns;
  - maintaining a public register; and
  - inquiring into any misconduct.
- 29.5. Ireland has established a Charities Regulatory Authority through the Charities Act of 2009 with the aim of securing compliance by charities with their legal obligations and to encourage better administration of charities. The Authority maintains a register of charities on which all charities must be entered and that is accessible to the general public.
30. Recent Australian reviews and inquiries have been broadly supportive of reforms which have occurred in England and Wales, Scotland, Ireland, Northern Ireland, Canada, the United States and New Zealand. In particular, recent reviews have supported the moves to simplify regulation through 'one-stop shop' regulation and introducing a statutory definition of charity in these comparable jurisdictions.

## THE CURRENT REGULATORY ENVIRONMENT

31. It is argued that the regulatory framework for the NFP sector is complex, duplicative and imposes a significant regulatory burden on the NFP sector without providing appropriate levels of governance, transparency and accountability.
- 31.1. Regulatory overlap between the Commonwealth, States and Territories and within the Commonwealth, States and Territories can result in NFPs facing a high regulatory burden, but a poor level of regulatory oversight. There is a strong argument that the wrong balance has been reached, whereby many NFP entities bear a compliance burden which is disproportionate to the level of risk posed, while others face no oversight.
32. Commonwealth, state, territory and local governments regulate different parts of the NFP sector for both different and overlapping purposes. For example, these laws provide tax and revenue concessions, exemptions from registration and permit requirements and exemptions or limitations on legal liability, and impose fundraising and lottery regulations.

33. This uncoordinated regulation of the NFP sector across Commonwealth, state and local government jurisdictions has resulted in overlapping and inconsistent regulatory systems. For example, there are more than 178 pieces of Commonwealth, state or territory legislation that involve 19 separate agencies regularly determining the charitable purpose or status of an entity.<sup>22</sup>
34. One of the most significant areas of regulatory overlap occurs where NFP entities operate in more than one jurisdiction and have more than one purpose. For example, entities operating in multiple jurisdictions may be endorsed to access taxation concessions (such as income tax exemptions and DGR status) at the Commonwealth level, and endorsed to access payroll tax, land tax and stamp duty concessions at the state and territory level and exemptions from rates at the local government level. In addition, they could receive direct funding through grants and contracts from various government agencies for service delivery.
35. Demonstrating compliance with these duplicative regimes may involve many applications and forms with subtly different criteria. In addition, funding arrangements between NFPs and different governments and government agencies can involve complex obligations, particularly in relation to the acquittal of grants, which can impose a high regulatory burden on NFPs. Operating within this often complex and burdensome regulatory environment may divert NFP resources from being applied productively for the benefit of the community, with unnecessary resources being expended on administrative requirements. Further, best practice regulation should ensure that choice of legal form should not result in significantly different regulatory requirements, in terms of governance and accountability requirements applying to NFPs, differences in regulatory requirements should be based on size, risk and access to government support.
36. The current regulatory framework provides inconsistent treatment of NFPs depending on entity type. Different regulatory systems for entities such as incorporated associations and charitable trusts lead to widely divergent regulatory outcomes based on entity type rather than activities or outcomes. As can be seen in the commercial sector, different entity structures exist to provide flexibility and entities should be free to make their own judgements about the benefits and costs of different legal forms.

## THE ROLE AND RESPONSIBILITIES OF A NATIONAL NFP REGULATOR

### The goals of NFP regulation

37. NFP regulation should promote a strong and sustainable NFP sector through good governance, transparency and accountability to underpin strong philanthropic engagement in the community. Regulation which achieves these goals is essential to underpin public confidence in the sector and to assist the public and government in the effective and efficient allocation of resources to meet community needs.
38. Regulation of the NFP sector should:
  - place minimal costs on NFPs in order to allow better direction of NFP resources to philanthropic objectives;
  - remove current regulatory duplication;
  - streamline requirements, including reporting, so as to provide consistency and minimise compliance costs;

- provide a ‘one-stop shop’ for NFP entities, to assist all NFP entities to more easily access information that helps them understand and comply with their regulatory obligations;
  - be simple, transparent and flexible;
  - provide NFP entities with certainty as to their rights and responsibilities; and
  - be proportional to the size and complexity of NFP entities, and to the public monies and risks associated with NFP entities.
39. Simplicity and transparency will provide a solid foundation, and sufficient flexibility for the sector to grow sustainably over time and tailor its services to meet those evolving community needs. Regulation should be flexible enough to allow opportunities for the sector to develop through expansion or consolidation. Regulation should also provide for the capacity development of NFP entities.
40. Appropriate monitoring and compliance activities are essential to public confidence in the sector, particularly given the trend for increased government funding for service delivery. Regulation must ensure that donors and volunteers are confident that regulation protects the assets of charities and NFPs and monies donated by the public, and minimises the risks of malfeasance.
41. A NFP regulator should work with the sector to provide support and education in order to improve understanding and compliance with regulatory requirements. A national NFP regulator can provide an interface for government and sector interaction, permitting a better exchange of information and allowing the government to better respond to emerging issues and to maintain a modern and adaptive framework.

### Consultation questions

- Q1 Are these goals appropriate and adequate for national regulation? Which of these are most important?
- Q2 Are there any other goals for national regulation?

## Scope of the national regulator

### Entities receiving public or government support

42. Effective regulation of NFPs must apply broadly across the sector, notwithstanding that the NFP sector encompasses a diverse group of entities which have a variety of legal forms. Efficient and effective regulation of the NFP sector must be focused around entities which receive public and government monies (through donations, taxation concessions, grants and contracts for services) to ensure that government and public support is directed to the effective provision of public benefits. Regulation should also reflect the increasing delivery of government services through the NFP sector.
43. There are approximately 600,000 entities in the NFP sector, of which it is estimated that around 400,000 may access Commonwealth tax concessions, either through the Australian Taxation Office’s (ATO) registration process for some NFP entities (endorsement) or by self-assessment. Hence the most comprehensive interaction between the Commonwealth and

the NFP sector is through taxation, and entities entitled to Commonwealth tax concessions make up a substantial proportion of NFP entities whatever their legal form.

44. Effective regulation should improve the confidence that government agencies can have in the NFP sector, particularly where agencies provide grants and contracts to NFPs. This would reduce the need for agencies to apply their own separate regulatory framework in order to ensure their programs are delivered appropriately.
  - 44.1. An option would be to regulate entities that: receive public donations; are in receipt of tax concessions or receive government grants and/or government funding.
  - 44.2. Regulation could also be proportional to the level of benefits and support received as well as taking into account the varying size and complexity of organisations in the NFP sector.

## Legal form

45. ASIC has the authority to regulate the 11,000 NFP organisations that are constituted as companies limited by guarantee. The Commonwealth also regulates the activities of 'professional trustee corporations.' Although regulation of charitable trusts is outside Commonwealth jurisdiction, trustees of charitable trusts may be subject to Commonwealth laws. Other corporate trustees may also be regulated by the Commonwealth.
46. Approximately 75 per cent of organisations in the sector (in the order of 440,000 organisations) are small unincorporated NFPs. These entities largely fall outside the current regulatory system, although many access taxation concessions.
47. Some NFPs are also established as cooperatives or Indigenous corporations.
48. Some NFP entities, such as churches and religious organisations, are incorporated by special statutes, or by Royal Charter, or are branches of international organisations, and also fall outside of the current regulatory system.
49. In addition there are specific regulatory issues raised by charitable trusts and incorporated associations.
50. National regulation could address the problems posed by inconsistent regulation, which partially results from different legal forms available for NFPs, by providing a consistent regulatory framework covering all entity types.

### Consultation questions

- Q3 What should the scope of a national NFP regulator be? What types of entities should be regulated by a national NFP regulator?
- Q4 Should some legal forms be treated differently? If so why?

## Charitable trusts

51. Charitable trusts are entities established to manage and distribute funds to individuals and organisations for a charitable purpose and for the benefit of an appreciable section of the public. They are principally governed by the law of equity as well as their respective trust deeds.

52. States and territories have primary responsibility for regulating charitable trusts. While the underlying principles relating to the regulation of charities are generally consistent, every state and territory has enacted its own legislation with local differences. The ordinary rules that apply to trustees also apply to trusts and trustees of charitable trusts and vary from state to state.
53. As stated in the PC Report, little is known about the total value of the assets and distributions of philanthropic intermediaries, such as charitable trusts. The report did, however, note that there are nine trustee companies managing about 2,000 charitable trusts and foundations with assets of about \$3.9 billion, which distributed \$280 million in 2006-07.<sup>23</sup>
54. The trust terms of a charitable trust are specified by the settlor at the time of establishment and thus, are fixed except so far as they provide for change. The default position is that the charitable objects can only be changed upon application (a *cy près* application) to a court.
55. It is the duty of the Crown, represented by the state Attorneys-General, to protect the property of a charitable trust. The Attorney-General is therefore always a necessary party to legal proceedings concerning charitable purposes. Specifically, an action for the regulation, internal management or enforcement of the charitable trust requires the Attorney-General to be a party to proceedings. Anecdotal evidence suggests that these interventions are costly and thus infrequent. There is a risk that charitable trusts are therefore under-regulated, and thus should be brought under the regulatory purview of a national regulator.
56. While the law of equity places various fiduciary duties on trustees, these duties are difficult to monitor and even harder to enforce. The state Trustee Acts provide little by way of minimum standards of governance or regulatory oversight. Finally, current judicial oversight and the required involvement of state Attorneys-General make for costly compliance and high administrative costs. The regulatory mechanisms and governance standards in respect of charitable trusts are probably inadequate, inefficient and in need of reform and modernisation.
57. Improvements to a subset of charitable trusts — private ancillary funds — were recently made through the introduction of the private ancillary fund guidelines. The guidelines establish: minimum governance standards; minimum distribution rates; investment rules and penalties for breaches of the guidelines. Additionally, the reforms made the Commissioner of Taxation responsible for the endorsement and ongoing compliance of private ancillary funds. These changes could provide a model to reform the regulation and governance of charitable trusts more generally.
58. More extensive improvements to charitable trusts have been made in overseas jurisdictions, such as in the UK, which enacted the Charities Act in 2006. The 'Charities Commission' (the Commission) which is responsible for regulating charities, including charitable trusts, seeks to ensure that trustees comply with their legal obligations in managing charities and identifies and investigates abuse and mismanagement in charities.<sup>24</sup> The involvement of the Commission has not only improved the governance of charitable trusts but has removed the need for judicial intervention by the Attorney-General, thus enhancing efficiency.

#### **Consultation question**

- Q5 Should the supervision of charitable trusts be moved from the state Attorney-General's to a national regulator?

## Incorporated associations

59. The PC Report explains that most organisations in the sector are unincorporated. However, for those entities that do incorporate, the most common corporate structures are companies limited by guarantee (under Commonwealth legislation) or incorporated associations under state or territory Acts.<sup>25</sup> As of the 2008-09 financial year, there were 136,000 NFP incorporated associations.<sup>26</sup>
60. Incorporated associations are governed by state and territory legislation and thus requirements differ between jurisdictions. States currently incorporate and register associations, impose some governance requirements and maintain and collect annual reports. The governance requirements imposed on incorporated associations are minimal. The PC Report noted that there is minimal regulatory oversight by the respective state registrars.
61. The PC Report noted the difficulties faced by incorporated associations that operate across state borders and called for greater harmonisation between the states with respect to regulation and reporting.<sup>27</sup>

### Consultation question

- Q6 Should regulation of incorporated associations (including reporting and governance) be moved to a national regulator? Should there be a residual role of the states in regulating incorporated associations?

## Functions the national regulator may undertake

### Access to taxation concessions

62. Registration as a NFP entity of a particular type (for example, endorsement as a charity under Australia's tax laws) allows many NFPs to access taxation concessions. As a result, access to Commonwealth and state tax concessions is a unifying theme in the diverse NFP sector.
  - 62.1. Governments support the NFP sector indirectly through tax concessions to ensure, encourage or assist in the provision of goods and services that would not otherwise be provided at the socially optimal level.
  - 62.2. At the Commonwealth level, income tax, GST, fringe benefits tax and DGR status tax concessions are available for eligible organisations.
  - 62.3. The states and territories also have their own tax concessions for NFPs, such as payroll tax and land tax concessions, with differing eligibility requirements.
63. Currently, the ATO administers Commonwealth tax concessions provided to NFP entities. Due to the significant tax concessions available to the sector and the need for many tax concessional entities to be endorsed to access the concessions, the ATO has effectively become, by default, the NFP regulator at the Commonwealth level.
64. Simplifying and streamlining the mechanisms for the assessment, granting and monitoring of tax concessional treatment provides a significant opportunity to reduce the red tape currently faced by the NFP sector.

65. Many limits and conditions imposed by the current taxation framework are a reflection of the existing minimalist regulatory framework. An improved regulatory framework could open up opportunities to simplify mechanisms for the assessment of eligibility for tax concessions. For example, as noted in the PC Report, the DGR framework could be simplified and streamlined.

65.1. Improvements in the taxation of NFP entities could have the significant benefit of delivering universally simplified and streamlined arrangements for a broad cross section of organisations in the NFP sector regardless of their particular legal form.

#### Consultation questions

Q7 What impacts would simplifying and streamlining mechanisms for the assessment, granting and monitoring of concessional tax treatment have on the NFP sector? In particular, what impacts would this have on small and new NFP entities?

Q8 What are the likely compliance cost savings from improvements to taxation arrangements?

Q9 Does the current complexity of the taxation framework discourage entities from applying to access tax concessions? If so, what elements of the framework are most problematic?

## Regulation and supervision

### Education and compliance

66. Currently education about governance and compliance obligations is provided to NFPs by government agencies that deal frequently with the NFP sector.

66.1. For example, a significant educational role is undertaken by the Office of the Registrar of Indigenous corporations (ORIC).

66.2. The ATO also provides educational information in relation to governance and compliance obligations at the Commonwealth level through its website, news service and through its dedicated information phone service. The ATO also maintains its engagement with the sector through the Charities Consultative Committee.

66.3. Some state departments with responsibilities for areas such as health, arts and sport also provide educational information to NFPs. In particular, those agencies which provide direct grants and have service delivery contracts with NFPs take on a role in educating the sector in relation to governance and compliance obligations.

67. Education about governance is also provided by non-government bodies such as Philanthropy Australia and the Australian Institute of Company Directors.

68. A new national NFP regulator could take over the role of educating the sector about governance and reporting standards and encouraging understanding and compliance with new regulatory arrangements.

69. The NFP sector, often staffed with volunteers, is generally less well supported to comply with regulatory requirements than are commercial businesses. A national regulator could engage with the NFP sector to assist organisations to understand their regulatory requirements and thus better facilitate philanthropy and voluntary compliance.

70. Educational initiatives could include a centralised portal of information for NFP entities, web-based training, new guidance materials, phone assistance, referral services for organisations requiring external advice, and ongoing consultation with the sector.

### Consultation question

Q10 What value would educational and compliance initiatives managed by a new national NFP regulator provide to NFP entities?

### Reporting

71. Australians have a high level of philanthropic engagement and provide significant philanthropic support to the sector. Despite this, the Australian public and Australian governments know very little about the operations of this growing sector. Improved reporting requirements could reduce the overall regulatory burden on the sector while ensuring better collection of information and helping to underpin public confidence in and increase engagement with the sector.
72. A national regulator could provide a central body to manage the collection of reports from the NFP sector, and provide a single reporting point, with a goal of 'report-once, use-often' for all NFPs.
73. Recent reviews of the NFP sector have called for significant improvement in relation to reporting requirements for NFPs. Current requirements do not reflect the level of funding provided to the NFP sector by the public and by governments. Improving reporting arrangements would not necessarily impose an increased regulatory burden on the sector. Some additional reporting may be required from some entities, however, other entities would have less onerous reporting requirements due to reduced duplication. Best practice reporting arrangements could simplify and streamline reporting for the NFP sector as a whole by better targeting collection of information.
74. Existing reporting arrangements are ad hoc, uncoordinated, complex and often focused on a particular activity of the entity (for example, acquittal of grants) rather than their finances or ongoing activities. This current system imposes a significant administrative burden on organisations but may not provide adequate information to the public, to recipients of NFP services or to governments.
75. Requirements for acquittal of grants differ as between the Commonwealth, states and territories, and in some cases between different Commonwealth, state and territory agencies. Acquittal processes for some grants are extensive while other processes allow more general reporting, such as a declaration by an organisation that it has spent the grant as agreed.
76. Many NFP entities must provide public reports in the form of general purpose financial reports and annual reports. Corporate entities provide reports to ASIC, and incorporated associations provide reports to state and territory incorporated association registrars.
77. A new national standard chart of accounts (SCOA) for reporting by the NFP sector has been developed and is being adopted by Australian, state and territory governments. The SCOA will make sure that different governments ask for basic financial information in the same way so that NFPs can report in a standard format. Adoption of the SCOA by NFPs is currently voluntary.

78. A significant proportion of the compliance burden on NFP entities relates to grant acquittal requirements imposed by funding agencies within the Commonwealth, states and territories. Firstly, in many cases, organisations are required either by legislative requirements or by some funding bodies to prepare special purpose financial reports on which to base grant acquittals. This imposes reporting obligations and associated costs that in many cases are excessive and cannot be justified. Secondly, these special purpose financial reports may also be required to be audited, which imposes additional costs because of the nature of the financial reports required.
79. In general, the terms of each grant differ as to the purpose of the grant and the services to be delivered, and also as to the format and general requirements of the grant documentation. Each one therefore requires individual assessment and reporting.
80. Standardisation of grant documentation formats across agencies is one way to simplify processes for the acquittal of grants. Alternatively, by focussing on improving general purpose reporting requirements and outcomes-based reporting, key information on the purposes, activities and turnover of an organisation could be centrally collected and used by all agencies. This would minimise red-tape and compliance costs for NFP organisations and would provide a basis for government agencies to undertake a risk assessment to allow them to determine whether or not more information is required from an organisation.

#### Information for reporting purposes

81. With the establishment of a new regulator, NFP entities within the scope of the NFP regulator could be required to lodge annual information statements. NFP entities would only be required to 'report-once' for standard reporting, and as such would no longer be required to report to ASIC or other Commonwealth agencies requiring the same information.
82. The full benefits of 'one-stop shop' reporting would require the participation of states and territories in removing reporting requirements to be substituted with a single report to a national regulator.
83. Entities that currently report to core regulators (such as ASIC) would no longer be required to report to them and consideration would need to be given to removing associated lodgement fees.

#### Tiered reporting

84. Reporting by NFP entities is an important governance and transparency mechanism, particularly given the public nature of, and interest in, these entities and their activities. However, it is also recognised that some NFP entities, particularly smaller entities, may have limited administrative capacity which may affect their ability to comply with extensive reporting requirements.
85. To reduce the regulatory burden on smaller NFP entities, a tiered system of reporting could be introduced.
  - 85.1. The data required for an annual information statement could be proportional to the size of the NFP entity and the level of tax concessions or grants provided to it, and could address the issues of how grants and donated monies have been utilised by organisations. Larger NFP entities could be required to provide more information as would DGRs. Small NFPs, who only access income tax exemptions, could provide an annual return in the form of a 'postcard' — a short information statement providing a new regulator with some basic information about the entity in order for a national regulator to undertake basic risk assessment for compliance purposes.

- 85.2. An annual information statement could also provide the opportunity for NFPs to provide qualitative statements reporting on their activities and achievements for the year. This could provide an opportunity for NFP entities to describe their position given that the nature of their activities and goals are not financially focussed like the reporting of commercial entities.
- 85.3. Some agencies may continue to require specific information from NFPs for the purposes of grant acquittals. How this information would be collected will need to be part of ongoing consultation. It may, for example, be sufficient if entities declare that they have spent their grant in the promised way.
- 85.4. The introduction of the new regulatory arrangements could be a staged process to ensure a smooth transition to a new reporting system.
86. In June 2010, the Australian Government introduced a similar differential reporting framework in respect of companies limited by guarantee registered under the *Corporations Act 2001*. These companies predominantly have a NFP focus. Under the new regime, a three tiered framework was introduced whereby requirements to provide audited financial reports and directors' reports were streamlined depending on the size and DGR status of the company.
87. States and territories also currently have various tiered reporting schemes in place for incorporated associations.

#### NFP information portal

88. There is currently no single source of public information on the activities of charities and other concessionally taxed entities. Some information is currently publicly available, for example, in relation to tax concessions on the Australian Business Register, financial reports from ASIC (fees generally apply for access to this information) and from state and territory agencies in relation to incorporated associations (though small fees also generally apply for access to this information). South Australia currently provides information in relation to charities and regulation which effects the NFP sector on its charities website.<sup>28</sup>
89. The lack of a single source of public information for members of the community seeking to access reliable information on charities and DGRs: reduces public confidence in the sector; restricts informed choices and philanthropy and public engagement more generally; and discourages appropriate levels of sector accountability and governance.
90. Introduction of a public information portal to provide a single, easily accessible source of detailed information about NFP entities in Australia could provide benefits to the public, the NFP sector and governments.
91. A NFP information portal could be based on overseas models, including the New Zealand Charities Commission website, the UK Charities Commission website and the Guidestar websites in the UK and USA.
92. An information portal could provide education and support materials for NFP entities as well as providing information on the activities and accounts of entities which receive tax concessions and broad statistics about the sector for the information of the public. The benefits of providing this information to the public could include both a higher level of confidence in relation to donations and volunteering, and a greater level of public understanding of the NFP sector as a whole. Both these benefits would support the philanthropic engagement of the public in the long term.

93. Some information, such as a brief annual activity statement and a summary financial report could be provided to the public. There is also an option for not all of the information provided to a new NFP regulator by NFP organisations to be made public. For example, some commercially sensitive information could be collected by the regulator for use of governments, but not published.

#### Standard Business Reporting

94. The Australian Government's Standard Business Reporting (SBR) initiative, implemented on 1 July 2010, allows businesses (including NFPs), with contemporary SBR-enabled software to lodge a range of financial and payroll returns to a number of state, territory and Australian agencies. It is possible to extend SBR to additional reporting requirements, including those specific to the NFP sector to reduce regulatory reporting burden.
95. SBR is a mechanism that allows reports to government agencies, using commercial business software, to be drawn from business accounting, payroll and other records to be compiled and submitted electronically through a single channel.
96. A core component is the SBR Taxonomy, a dictionary of agreed and harmonised definitions providing context for information sought by agencies. The SBR Taxonomy has been designed to be compliant with Australian and international accounting standards. It allows individual elements of data to serve multiple purposes without requiring additional manipulation.
97. SBR provides a single 'sign-on' credential and does not require businesses to log onto multiple portals.
  - 97.1. It reduces the reporting burden for organisations through reduced effort in compiling and submitting reports to government agencies. In particular, it does this by using commercial business software to automatically pre-fill information, providing an electronic interface to agencies directly from accounting software, and providing validation and confirmation of receipt of reports.
98. SBR has been co-designed by Australian, state and territory government agencies in partnership with software developers, businesses and their accountants, bookkeepers, tax agents and payroll.
99. A prerequisite for extending SBR into specific NFP reporting would be the clarification and consolidation of reporting requirements for all agencies and jurisdictions. In addition, further consultation with stakeholders such as the software developers that support this sector would be necessary to ensure their support for this expansion.
100. Some examples of the reports currently in scope for SBR include the Business Activity Statement (for the ATO), financial statements (for ASIC), and payroll tax returns (for state and territory government revenue offices).
101. Extending SBR to a new NFP reporting framework would provide a consistent government approach to reporting for software developers and businesses and leverage the infrastructure and mechanisms that have been developed for SBR.

### Consultation questions

- Q11 What benefits would a 'report-once, use-often' model of reporting offer?
- Q12 What information do NFP entities currently provide to government agencies? Do these include general purpose financial reports and fundraising reports? What other reports are currently required? What do the reporting requirements involve? What information is required for the purposes of grant acquittals?
- Q13 How significant is the compliance burden imposed by requirements for acquittal of grants? Where could these be simplified?
- Q14 What benefits would the establishment of a NFP sector information portal have for the public, the sector and governments? What information should be available on the portal?
- Q15 What information might need to be provided to a national regulator but not made public through a NFP information portal?
- Q16 What benefits would be provided by the application of SBR to the NFP sector, following the implementation of the SCOA so as to minimise any additional compliance costs?
- Q17 Given its voluntary nature, are many NFP entities likely to use SBR? What barriers, such as preferences for providing reports in paper form or reluctance to upgrade accounting software, might reduce usage of SBR by NFP entities?

### Governance, disclosure and compliance

102. A best practice regulatory framework would ensure that appropriate governance arrangements are in place for the NFP sector, and that entities are accountable and transparent. Such a framework would provide a basis to improve public confidence in the sector and encourage philanthropic giving. Recent reviews have highlighted that a single regulator would be best placed to manage governance requirements and compliance activities.
103. Current governance and accountability arrangements do not meet community expectations in relation to governance arrangements for organisations in receipt of public monies. While recent trends have seen higher levels of governance and accountability required of both the commercial and government sectors in Australia, the NFP sector has largely been ignored. Governance and accountability arrangements in the NFP sector have also not kept pace with international trends to improve the governance of the NFP sector.
104. The introduction of a public information portal is a measure which could make the activities of NFPs more transparent. A public information portal could assist with a continuation of some self-regulation as NFPs would likely be aware that their actions, including any malfeasance, would be more exposed to public scrutiny. As a consequence, NFPs would be likely to act with higher levels of accountability.
105. A best practice regulatory framework would comprise a core set of rules setting minimum governance standards. Additional governance standards may apply to entities depending on the size, purpose and complexity of the NFP. For example, additional rules may be required for larger or more complex NFPs, whilst only the core rules would apply to smaller NFPs.

106. Philanthropy Australia refers to the US-based Council of Foundation's definition of governance as requiring entities to 'hold ourselves responsible to those who created us, those with whom we currently interact, and those who may look to us in the future.'<sup>29</sup> The core rules should seek to uphold such a definition of governance.
107. The core rules could cover three areas. Firstly, the rules could cover duties of responsible individuals (such as directors, trustees and office bearers). These duties could cover a duty of compliance which would require responsible individuals to comply with relevant laws, regulations and governing documents. They could also include a duty of prudence which would require responsible individuals to exercise prudence with regards to the entity's finances and any financial decisions and a 'fit and proper person' test to ensure that suitable and competent persons are managing NFPs. Finally the rules could comprise a general duty of care, which would require a responsible individual to act with a standard of care reasonably expected of a reasonably competent responsible individual. In Victoria, the *Associations Incorporation Amendment Act 2010* proposes to mandate additional duties on office holders, including former office holders. This extension could feature as part of the best practice framework.
108. The second core rule could comprise a model decision making framework, which would set out the processes and requirements for decision making by the NFP's responsible individuals. This framework would be tailored to an entity's size, so that the more complex the organisation, the more sophisticated the decision making framework.
109. The final core rule could comprise an accountability framework, which would set out the kind of documents needed to be disclosed and to whom. The framework could include auditing requirements which would be tiered and tailored to an entity's size, so that the larger or more risk-prone an entity, the more demanding the accountability, auditing and reporting measures. In addition, the framework could cover investment rules, responsible fund management obligations, and limitations on related party transactions these would include rules to prevent private benefits flowing to members or associates of members of a NFP.
110. The regulatory framework could be further bolstered by giving the regulator powers in relation to governance and regulatory oversight.
111. These powers could cover: asset protection, which would enable the regulator to protect an NFP's assets if malfeasance were detected; suspension and/or replacement of responsible individuals in the case of any breach of core duties; powers to register and deregister any NFP; the power to enforce governance rules; the power to commence investigative processes to uncover actual or potential malfeasance; the power to issue warnings and penalties to non-compliant NFPs; and finally the power to undertake dispute resolution processes, which would permit the regulator to intervene in any dispute of which an NFP is party, both within the NFP and between the NFP and another entity.
- 111.1. Victoria has clarified its existing dispute settlement provisions as part of its draft law. The provisions make clear that an incorporated association must ensure that each party to a dispute has an opportunity to be heard before a decision is made, and that the dispute must be resolved by an unbiased decision maker. These provisions could form the basis of the national regulator's dispute resolution powers.
112. Governance reforms could be progressed alongside the broader harmonisation and standardisation process so that state and Commonwealth regulatory laws apply consistently to NFPs. This would provide NFPs with greater certainty as to their obligations and mitigate the likelihood of inconsistent governance arrangements applying to NFPs.

### Consultation questions

Q18 Are the suggested core rules and regulatory framework adequate?

Q19 What powers does the regulator require to improve governance and regulatory oversight?

### Fundraising

113. The complexity of legislation and regulation in the NFP sector imposes a significant administrative burden on NFPs, diverting resources from their core activities, particularly where organisations undertake fundraising activities in multiple jurisdictions. Complexity also arises in this area due to broadly targeted internet, telephone, television and radio appeals which inevitably involve jurisdictional issues.
114. The Ministerial Council on Consumer Affairs (MCCA) is now undertaking a project to harmonise fundraising legislation under the oversight of COAG's Business Regulation and Competition Working Group. At present, fundraising regulation ranges from no regulation in some jurisdictions to significant regulation in other jurisdictions.
115. MCCA will issue a paper exploring the options for harmonised NFP fundraising laws in early 2011. This paper will explore the arrangements for the administration and enforcement of these laws, as well as their detailed content, and their interaction with the regulatory framework for NFP governance and accountability.
116. There is scope for the national regulator to play a role in administering harmonised fundraising legislation. Alternatively, this legislation could be managed at state and territory level. A national regulator administering such laws may better reflect the increasing cross-border nature of fundraising, particularly through centralised and internet public appeals.

### Consultation question

Q20 What role should a national regulator play with respect to fundraising?

### Review and appeal procedures

117. Decisions of Australian Government bodies are subject to review and appeal procedures including: internal review by the body that made the decision; independent review by the Administrative Appeals Tribunal; and finally a right to appeal to the federal courts. This administrative review process could be applied to a national NFP regulator.
118. Existing Commonwealth, state and territory agencies could also be given a right of appeal against decisions of the regulator to register a NFP entity. This appeal right could be used as a mechanism to protect the integrity of various Australian laws, which these existing agencies have primary responsibility for administering.

### Constitutional issues and jurisdictional issues

119. Regulation of the NFP sector is currently a shared responsibility between the Commonwealth and the states and territories.

120. The Commonwealth primarily regulates the NFP sector through both the tax system and the corporate regulatory framework. The Commonwealth also places requirements on NFP entities which access Commonwealth grants and enter into contracts with the Commonwealth.
121. Regulation at the state and territory level can include regulation for state taxation purposes, of incorporated associations, of charitable trustees, for consumer protection purposes related to fundraising by NFPs, and for access to state grants and contracts.
122. The complex interrelationship between state and territory regulation in the NFP sector will necessarily influence the form which the national regulator would ultimately take. The extent of a national regulator's powers would depend on the cooperation of the Australian, state and territory governments.
  - 122.1. Should the states and territories choose not to participate, the Australian Government will need to consider the extent to which it could legislate to establish a full national regulator.
123. There may also be scope for further harmonisation and simplification of current regulatory requirements. As discussed above, some harmonisation has already occurred in certain areas, including in relation to the SCOA.

### **Establishing a national NFP regulator**

124. Establishing a national NFP regulator may require either a referral of powers from the states to the Commonwealth and/or harmonisation of legislation.
125. Under a referral of powers, the states would refer certain powers to the Commonwealth, and the Commonwealth could use those powers to regulate NFPs. This option is the simplest option, but it involves a transfer of powers from the states to the Commonwealth. There is also an option for an intergovernmental agreement to allocate responsibilities in this area and to govern ongoing maintenance of these issues.
126. Common law jurisdictions which do not have federal systems, such as New Zealand and Ireland, have recently established national regulators.
127. Common law jurisdictions with a federal system similar to Australia's, such as Canada and the United States, regulate the NFP sector using their taxation powers.
  - 127.1. In Canada, regulation of most activities of charities is the responsibility of provincial governments, while income tax laws are generally the responsibility of the national government. However, Canada's Charities Directorate, within the Canadian Revenue Agency, has responsibility for regulation of income tax matters as well as a significant role in relation to improving governance and transparency with respect to NFPs, by limiting access to tax concessions to those NFP entities who seek registration and therefore comply with regulatory requirements.
  - 127.2. Similarly, given its federal system, the main interaction of the United States government with the NFP sector is through the taxation power, with reporting and governance requirements tied to access to tax concessions administration is through the Internal Revenue Service.

### Consultation questions

- Q21 What problems arise from the complex interrelationship between Commonwealth, state and territory responsibilities in this area?
- Q22 What might be the implications of the different approaches of referral of powers or harmonisation of legislation?

## The form of the national regulator

128. A new national NFP regulator could be constituted in different forms. The form of the regulator would affect the types of roles that the national regulator undertakes.
129. Options for the structure of the regulator include:
- a new national body to act as a national regulator (similar to the New Zealand Charities Commission); or
  - a new Commonwealth body to act as a regulator for the purpose of Commonwealth laws only.
130. However, in the interim, regulation could be improved with:
- a new body initially established within, but structurally separated from, the ATO, to progress immediate taxation and regulation improvements at the Commonwealth level, while discussions between the Commonwealth, states and territories are progressed (similar to Canada's Charities Directorate); or
  - a new body initially established within, ASIC.

## New national regulator

131. An independent national NFP regulator would provide the greatest benefits to the public, the sector and to governments, in terms of reducing red-tape and simplifying and streamlining reporting arrangements.
132. The benefits of an independent national NFP regulator have been discussed in detail by recent reviews and inquiries, and the benefits that such a model would provide have been widely accepted. This paper does not seek to re-examine issues which were examined in detail by these reviews.

## New Commonwealth regulator

133. A new regulator could be created for regulation under Commonwealth law only.
134. There would be scope for a new Commonwealth regulator to administer simplified and streamlined Commonwealth regulation and taxation arrangements.
135. A new Commonwealth body would come at significant cost compared with a body established within another Commonwealth entity which would need to be considered under a cost/benefit framework and the Commonwealth's fiscal constraints.

136. A significant proportion of the existing regulatory duplication would remain if a Commonwealth only regulator were to be established.

### A new body within the ATO

137. Given the importance of the Australian Government's interaction with the NFP sector through NFPs accessing Commonwealth tax concessions, a national NFP regulator could be established under the initial stewardship of the ATO. In many ways the ATO already acts as the default regulator, with significant involvement in the sector through its offices around the country, and its role in processing access to tax concessions for which the sector is eligible. Additionally, initially establishing a national NFP regulator within the ATO would have the benefit of taking advantage of the ATO's presence in all states and territories and in a diverse range of locations across each state and territory.
138. The regulator could initially sit within the ATO, but could be separately structured, branded and identified. Structural separation and branding would help to address the risk of a perceived conflict of interest between the Commissioner of Taxation's revenue collection focus and his role as default NFP Commissioner.
139. This approach would be similar to the approach adopted in Canada and the United States (which are federations like Australia with limited powers of the national government). Both countries use their relevant tax authority to regulate charities, with an explicit 'Charities Directorate' established within Canada's tax authority.
140. If the regulator was initially established within another agency or as an independent statutory body, the ATO would maintain its current role in the regulation of the NFP sector. This would limit additional costs to the Commonwealth of establishment and minimise the time of establishment, as the ATO has the greatest Commonwealth expertise in charitable and NFP law.
- 140.1. This would be similar to the model followed by the UK where charities that are registered with the Charity Commission Secretary can apply to HM Revenue & Customs for recognition as a charity for tax purposes and access to tax exemptions.

### Within ASIC

141. Under the Commonwealth's existing powers, the existing corporations regulator, ASIC, could be given an increased role with respect to regulation of the NFP sector.
142. ASIC is currently responsible for the regulation of approximately 11,000 NFP entities incorporated as companies limited by guarantee under the *Corporations Act 2001*. ASIC also has responsibility for registration of incorporated associations and cooperatives if they wish to operate outside of their home jurisdiction.
143. The PC Report recommended that a 'one-stop shop' for Commonwealth regulation of NFPs should be established as a statutory body or organ within ASIC. The PC Report positively identified that ASIC: already registers and regulates a number of NFP entities; is the national portal for the collection of corporate and financial public record information entities under the *Corporations Act 2001*; and that there would be synergies associated with ASIC IT services, corporate governance education support and national presence.
144. However, for the corporate regulator, focussed on corporate and financial market matters, to even be considered as an appropriate body to accommodate a statutory body committed to the regulation of the NFP sector, all NFPs to be regulated would need to be incorporated

entities, this would reduce the current flexibility of legal structure. While ASIC does provide guidance material on registering charities and NFP companies under the *Corporations Act 2001*, this guidance is general in nature and concerned primarily with compliance obligations. Furthermore, ASIC's current interaction with the NFP sector relates primarily to approximately 11,000 entities which represents approximately 2 per cent of the NFP sector. The PC Report also noted that the corporate focus of ASIC may restrict the potential for the NFP regulator to expand into 'a more development focused role.'

145. Similarly to the ATO, ASIC would be able to provide regulation for limited additional costs to the Commonwealth compared to a new Commonwealth body. However, it is unlikely to be able to regulate at a similar cost to the ATO as the ATO has appropriate systems and technical knowledge of the sector.

### Consultation questions

- Q23 What form of the national regulator best meets the objectives of simple, effective and efficient regulation of the NFP sector?
- Q24 Would a Commonwealth only regulator provide sufficient benefits to the sector?
- Q25 Are there benefits from establishing an interim regulator through an existing Commonwealth regulator, to undertake immediate reform?

## SECTOR SPECIFIC REGULATION OF THE NFP SECTOR

146. The role of a new NFP regulator will need to take account of current regulatory frameworks which apply to specific areas of the NFP sector.
147. Currently, regulation of NFP Indigenous corporations is undertaken by ORIC and a regulator for the NFP housing sector has been announced.
148. The role of a new NFP regulator in these areas of the NFP sector would need to be assessed through ongoing consultation with stakeholders.

## ORIC

149. The Registrar of Indigenous corporations is an independent statutory office holder responsible for the regulation and governance of Indigenous corporations registered under the *Corporations (Aboriginal and Torres Strait Islander) Act 2006*.
150. Registration under the Act is mostly voluntary. However, some corporations, for example, registered native title bodies corporate determined by the Federal Court of Australia under the *Native Title Act 1993* and royalty associations under the *Aboriginal Land Rights (Northern Territory) Act 1976*, are required to register under the Act.
151. ORIC supports and regulates the corporations that are incorporated under the Act. The activities of ORIC include: advising organisations on how to incorporate; training of directors, members and key staff in good corporate governance; mediating disputes; making sure corporations comply with the law and intervening when needed.

152. ORIC regulates approximately 2,600 Indigenous corporations, approximately 80 per cent of which are NFP organisations.
153. Thus, there would be significant similarities and points of overlap between the responsibilities of the national regulator and ORIC, including registration and regulation of NFP Indigenous organisations, providing a single reporting point and the provision of information on the performance of organisations to the public.
154. However, some Indigenous corporations have several unique features which pose challenges in relation to their regulation, such as language barriers, problems posed by remote and rural locations and governance requirements under the Act that directors be of Aboriginal and/or Torres Strait Islander descent. These requirements mean that ORIC currently takes on a more facilitative role than other regulators.
155. There are several options for the interaction of ORIC and the national NFP regulator. ORIC could be subsumed by the new regulator, or the collection of reports and governance functions of ORIC could be transferred to the new national regulator. ORIC could also be housed within the new regulator but identified and structured separately in order to recognise the unique governance requirements of Indigenous corporations.

## Housing regulator

156. Sector specific regulation of the NFP sector is currently being developed in relation to the provision of housing services by NFP entities.
157. In a joint communiqué of 16 December 2010, the Housing Ministers Conference agreed to implement a nationally consistent regulatory system for NFP housing providers, with the goal of providing more opportunities for growth within the NFP housing market.
158. Regulation of the housing sector would be based on governments collaborating in relation to housing in order to implement a nationally consistent regulatory system based on a national code that will aim to promote the growth of the NFP housing sector.

### Consultation questions

- Q26 What would be the advantages and disadvantages of incorporating the functions of ORIC and the proposed housing regulator into a national regulator? What alternative approaches are available to avoid duplication?
- Q27 What benefits could flow from a national regulator maintaining a dedicated subsection focusing on Indigenous corporations and/or housing?

## FUNDING IMPLICATIONS

### Options for funding regulator

159. The regulator could be fully funded by the Australian Government, however, this would limit the resources of the regulator and consequently reduce the education and support that could be provided by a national NFP regulator.
160. The regulator could be partly funded by a co-contribution from regulated NFP entities.

160.1. A small contribution towards regulation of the sector could be collected along with the lodgement of annual reports.

160.2. A regulatory contribution could take the form of a small flat fee or could be charged based on entity size. Small NFP entities, such as those under a minimum gross annual income, could be exempted from paying the regulatory contribution. The amount of the contribution could be reviewed annually by the Treasurer.

160.3. A differential fee for paper and electronic returns, such as that charged by the New Zealand Charities Commission could also be adopted although this may be seen to unfairly discriminate against smaller, less technologically equipped organisations.

160.4. A regulatory contribution to a NFP regulator could replace the current fees and charges paid by NFPs to various agencies, such as annual ASIC fees and annual state regulatory fees. Consequently NFPs would be able to provide only one fee to one body under a national NFP regulator.

### Funding NFP regulators in comparable jurisdictions

161. Administrative fees are collected from charities in several comparable jurisdictions.

162. In the United States applications to the IRS for tax-exempt status require a filing fee. This fee is US\$400 for organisations with annual gross receipts of less than US\$10,000 during the preceding four years and US\$850 for organisations with annual gross receipts of US\$10,000 or more during the preceding four years. In setting its fees, the IRS considers the number of cases and the actual time and costs of reviewing the applications.

163. Application for registration with the New Zealand Charities Commission is free of charge. However, annual returns must be provided at a cost of NZ\$76.67 for paper-based annual returns and NZ\$51.11 for online returns. Charities with a gross annual income below NZ\$10,000 are not required to pay an annual return fee.

### Funding other Australian regulatory regimes

164. Other Australian regulatory regimes are funded, or partly funded, by the sector that is regulated. For example, the Australian Prudential Regulation Authority (APRA) imposes a supervisory levy, determined by the Minister for Financial Services, Superannuation and Corporate Law, on regulated entities such as banks, insurers and superannuation fund trustees. The ATO imposes a regulatory levy on self-managed superannuation funds.

#### Consultation questions

Q28 What level of contribution should NFP entities make to the cost of the national NFP regulator?

Q29 Should there be a differential cost for smaller NFP entities?

### DEFINITIONAL ISSUES

165. Jurisdictions such as England and Wales, Ireland, Northern Ireland and New Zealand have introduced statutory definitions of 'charity.'

- 165.1. Australia does not have a statutory definition of charity. The *2001 Report of the Inquiry into the Definition of Charities and Related Organisations* recommended the definition of charity be defined by statute. The Charities Bill 2003 proposed a statutory definition of charity, which did not proceed and instead minor legislative changes were made by the *Extension of Charitable Purpose Act 2004* in relation to certain activities.
- 165.2. In Australia the definition of charity has been established under the common law, which is largely based on the Preamble to the Statute of Charitable Uses, enacted by the English Parliament in 1601 and *Pemsel's case* in 1891 (which classified the categories of 'charitable' under four heads) and subsequent court cases.
- 165.3. The key principles of the common law definition of charitable purpose could be codified based on the existing four common law heads of charitable purpose. Therefore in order to be charitable: an entity must be NFP; the dominant purpose or purposes must be charitable; and it must operate for the public benefit.
166. A statutory definition of charity would allow modernisation and flexible changes to the meaning of 'charitable' to be routinely considered by Parliament. Parliamentary consideration of changes to a legislative definition of charity can ensure a more modern, flexible and cost effective approach. Parliament can undertake greater investigation and review than the courts and can consider contemporary Australian societal needs and expectations. This option may reduce the amount of litigation, noting that legal challenges are a poor use of the resources of NFP entities.
- 166.1. Overseas jurisdictions have had positive outcomes in legislating a definition of charity. The definitions adopted by various overseas jurisdictions and their experience in implementing a definition change will provide valuable guidance in developing a statutory definition and allow best practice to be adopted.
167. Currently the determination of whether or not an organisation, or activity, is charitable involves a high degree of uncertainty and imposes a significant administrative burden on both NFP organisations and government agencies.
- 167.1. For example, the plethora of legislation (more than 178 pieces of Commonwealth, state or territory legislation) which involve separate government agencies regularly determining the charitable purpose or status of an organisation illustrates this inefficiency.
- 167.2. A statutory definition of charity could provide greater certainty in the determination of whether or not an organisation or activity is charitable, for NFP sector, for regulation, and for the general public, thereby reducing costs of regulation and administration. A statutory definition of charity could also provide a platform to harmonise the definition of charity between the Commonwealth, state and territory jurisdictions (subject to consultation with the states) and could be administered by a new national NFP regulator.
168. The benefits of a statutory definition of charity were discussed by both the AFTS review and the PC Report, which recommend modernising and codifying the definition of charity in line with the *2001 Report of the Inquiry into the Definition of Charities and Related Organisations*.

### **Consultation questions**

- Q30 Would a statutory definition of charity achieve the goals of greater certainty and administrative efficiency in relation to the determination of charitable purpose, particularly in relation to determining access to taxation concessions and across different jurisdictions and laws?
- Q31 Is Parliament a more appropriate body to define charitable status than the courts, given its ability to be more responsive to changing community needs and expectations?

## APPENDIX A — REGULATORY MODELS

### NFP REGULATION IN ENGLAND AND WALES

169. The Charity Commission is the independent regulator of charities in England and Wales. It is a body corporate managed by an executive board. Its role is to provide advice and guidance to registered charities, ensure that they are accountable and meet their legal obligations, and to identify and investigate abuse and mismanagement through compliance activities.
170. Once a charity is registered it can make an application to HM Revenue and Customs (HMRC) for recognition as a charity for tax purposes.
- 170.1. A recognised charity may qualify for a number of tax exemptions and reliefs on income and gains, and on profits for some activities.
- 170.2. Charities and community amateur sports associations can also benefit from the Gift Aid scheme.
171. Like all organisations, charities are subject to the laws of England and Wales and may be regulated by other government bodies. For companies, the law of England and Wales will normally apply if the company itself is registered in England and Wales.
172. Charitable organisations that have an income of more than £5,000 must register with the Commission.
- 172.1. If an organisation's income does not exceed £5,000 it is not mandatory to register as a charity with the Commission. It can, however, register as a charity with HMRC for tax purposes only. However, many choose to be regulated as this increases public confidence in them.
173. The information a charity is required to prepare or send to the Charities Commission (as well as audit requirements) is determined by whether the charity is incorporated or not and its annual income. In general, charities with an income over £10,000 must submit an annual return to the Commission with the charity's accounts and annual reports. If a charity's income is £10,000 or less, the charity must prepare accounts and advise of changes to the charity's details including income and expenditure each year.
174. The Commission holds an online Register of Charities which records details of registered charities in England and Wales with information provided from the annual return or update.
- 174.1. The Register provides information about the activities and finances of each charity. It shows details of trustees and whether they have complied with their reporting and accounting responsibilities.
- 174.2. The entries for larger charities with income in excess of £500,000 include a financial profile. The Register is maintained from information provided by charities in their annual return or update.

175. Guidestar UK also provides information on charities in England and Wales and contains a search engine. Charities can edit and add to their entries online. The Charities Commission provides Guidestar with existing public data on charities as well as electronic copies of annual reports and accounts. The resource is free to charities and users.

## NFP REGULATION IN NORTHERN IRELAND

176. The Charity Commission for Northern Ireland was created under the Charities Act (Northern Ireland) 2008 and is the new independent regulator of charities in Northern Ireland. It has a Board comprising a Chief Commissioner, a Deputy Chief Commissioner and up to five Charity Commissioners, all on a part-time basis.

177. Before the introduction of the new charity legislation, there was no local registration of charities and only limited control of how charities were run. Usually charities had applied to HMRC for tax benefits and received a reference number.

178. The general functions of the Commission are to:

- determine whether institutions are or are not charities;
- identify and investigate apparent misconduct or mismanagement in the administration of charities and taking remedial action;
- encourage and facilitate the better administration of charities;
- determine whether public collection certificates should be issued;
- obtain, evaluate and disseminate information in connection with the performance of any of the Commission's functions or meeting any of its objectives (including the establishment and maintenance of an up-to-date register of charities); and
- give information or advice, or making proposals, on matters relating to any of the Commission's functions or meeting any of its objectives.

## NFP REGULATION IN SCOTLAND

179. The Office of the Scottish Charity Regulator (OSCR), established under the Charities and Trustee Investment (Scotland) Act 2005, is the independent regulator and registrar of charities in Scotland. There is no fee for registration of a charity.

180. An organisation registered with OSCR can make an application to HMRC for recognition as a charity for tax purposes.

181. Charities also have to comply with other relevant legislation, for example charitable companies must also comply with company law.

182. The roles of the OSCR are to:

- determine whether bodies are charitable;
- keep a public register of charities (the Scottish Charity Register) and review these entries;
- encourage, facilitate and monitor compliance by charities;

- identify and investigate misconduct of charities and take remedial action; and
  - give information and advice or make proposals to Scottish Ministers of matters relating to OSCR's functions.
183. The OSCR publishes a range of guidance materials to assist charities and their professional advisers to meet their responsibilities under the 2005 Act.
184. The public register must contain the following information for each charity:
- the name of the charity;
  - the principal office or the name and address of one of the charity trustees (unless, it is necessary to protect an individual or the charity's premises);
  - the charity's purposes; and
  - certain other information (including whether it is a designated religious charity or national collector).
185. Registered charities must provide the OSCR with certain annual information about the way in which they operate and how they use their resources. Charities are required to submit:
- an annual return;
  - a supplementary monitoring return (for charities with a gross income of £25,000 or more); and
  - a signed copy of annual accounts.
186. Most charities can prepare simple accounts but where their gross income is £100,000 or more, or the charity is a company, it must prepare more detailed accounts.

## NFP REGULATION IN NEW ZEALAND

187. The New Zealand charities regulator is the Charities Commission which was established by the *Charities Act 2005*. It is an Autonomous Crown Entity (ACE) which came into existence on 1 July 2005.
- 187.1. Autonomous Crown Entities are established by, or under, an Act and must have regard to government policy when directed by the responsible Minister.
188. The role of the Commission is to:
- receive and process applications for registration as charitable entities and monitor entities to ensure they continue to be qualified for registration;
  - educate and assist charities in relation to matters of good governance and management;
  - maintain and compile a public register of charities;
  - receive and process annual returns submitted by charitable entities;

- supply information and documents in appropriate circumstances for the purposes of the Inland Revenue Acts;
  - inquire into charitable entities which may have breached the requirements of a charitable entity; and
  - consider and make recommendations and carry out research on any matter relating to charities.
189. Registering with the Commission is voluntary. A charity that chooses not to register can still call itself a charity and solicit funds from the public. However, it is not eligible for tax concessions.
190. In many cases, these organisations also have to comply with other legal requirements relating to their rules. This will be the case if they are registered under the *Incorporated Societies Act 1908*, the *Charitable Trusts Act 1957* or the *Companies Act 1993*.
191. Application for registration is free of charge. However charities are to furnish an annual return each year at a cost of \$76.67 for paper based annual returns and \$51.11 for online returns. Charities with a gross annual income below \$10,000 do not pay an annual return fee.
192. NZ Inland Revenue administers charitable tax exemptions. Generally, registration by the Commission is accepted by Inland Revenue so that registration will, in most cases, lead to tax exemption. Inland Revenue continues to administer donee status. Organisations do not need to be registered with the Commission to get donee status. Individuals can claim a tax rebate for a donation they make to an organisation that has donee status.
193. The Charities Register includes the following information:
- the name, address and registration number of the charity;
  - names of all past and present officers since the organisation was first registered;
  - a copy of its rules;
  - the application for registration as a charitable entity (including all accompanying information and documents); and
  - annual returns.
194. Charitable organisations are required to notify the Commission if certain core information has changed during the year. This ensures that all information that is held on the Charities Register is as up to date as possible.

## NFP REGULATION IN IRELAND

195. In Ireland, the Charities Act of 2009 establishes a Charities Regulatory Authority with the aim of securing compliance by charities with their legal obligations and to encourage better administration of charities.
196. The establishment of the Authority means that functions will be transferred from other institutions to the Authority such as functions of the Attorney-General that relate to charities. The Act has commenced with individual provisions.

197. The intention of the Act is that an integrated system of mandatory registration and proportionate regulation and supervision of the charities sector will be introduced for the first time in Ireland.
198. The Authority's role will principally be to increase public confidence in the charities sector through effective oversight, promotion of compliance, better administration and providing guidance to charitable organisations.
199. The Act provides for a Register of Charities on which all charities operating in the jurisdiction must be entered and that will be accessible to the general public.
200. The Revenue Commissioners alone determine whether a body is entitled to charitable tax exemption under the *Taxes Consolidation Act 1997*. Any organisation in receipt of charitable tax exemptions from the Revenue Commissioners on the establishment day is to be automatically deemed to be registered with the Authority.
201. The Act provides for proportionate regulation in recognition that many charitable organisations are small with limited resources. There are varying reporting and audit requirements depending on whether a charity's income or expenditure is above or below a prescribed level.
202. All charitable organisations will be required to make annual reports on their activities to the Authority which will generally be accessible to the public.

## NFP REGULATION IN THE UNITED STATES

203. In the US, all federal and state laws pertain, directly or indirectly, to tax-exempt organisations. Most of the laws that pertain to the concept and creation of these organisations originate at the state level, while most laws concerning tax exemption are generated at the federal level.
  - 203.1. Federal tax-exempt status does not guarantee exemption from state and local taxes and vice versa.
204. At the federal level, the US IRS is responsible for the administration of tax-exempt organisations.
  - 204.1. Charitable organisations are eligible to attract deductible charitable contributions (but not including charitable organisations that test for public safety).
205. The role of the IRS is to: consider whether an organisation meets the requirements for tax exemption; assist tax-exempt organisations with their tax law responsibilities; and improve compliance.
206. To obtain tax-exempt status an organisation must apply for recognition for exemption. The application must be accompanied by a user fee (currently US\$400 which increases to US\$850 if the gross receipts for the organisation are expected to average US\$10,000 or more over the preceding four years).
  - 206.1. Churches and public charities whose gross receipts are not more than US\$5,000 are exempt from this requirement.
207. Most tax-exempt organisations (other than churches) must file a yearly return or notice and a tax return where there is unrelated business income exceeding US\$1,000 with the IRS. Since

2008, small tax-exempt organisations (annual gross receipts of US\$25,000 or less) are required to lodge an e-Postcard to the IRS.

208. In general, a tax-exempt organisation must make available for public inspection and on request its exemption application with all supporting documents and its annual information return and annual returns. The IRS must also make this same information available to the general public.

208.1. Charitable organisations must also make available its annual business income returns for public inspection which includes disclosure of unrelated business income.

208.2. GuideStar is also a source of information about US NFPs.

## NFP REGULATION IN CANADA

209. In Canada, like Australia, the laws relating to charities are primarily the responsibility of sub-national governments, while income tax laws are generally the responsibility of the national government. The national government's control over charities is mostly achieved through provisions relating to taxation.

210. The CRA is Canada's federal agency responsible for administering the Income Tax Act (the Act). The Charities Directorate of the CRA, is responsible for administering the Act in relation to registered charities and certain other 'qualified donees.'

211. The role of the Charities Directorate is to review applications for registration; provide guidance on maintaining registered status, ensure registered organisations comply with registration requirements; develop policy; and provide information and education programs for the charitable sector and for donors.

212. Registered charities are required to file an annual information return with the CRA and must meet certain requirements of the Act concerning their expenditures and activities. The CRA maintains a list of charities where the following information is publicly available:

- whether a charity is registered under the tax legislation and is therefore eligible to issue official donation receipts for income tax purposes;
- a charity's information return;
- a charity's financial information (assets, liabilities, income, and expenditures);
- the activities of a registered charity; and
- how to contact a charity.

213. Within the federal government, there are other government agencies with a regulatory role for specialised entities, for example, Industry Canada which has responsibility for federal incorporation.

214. The regulation of charities outside income tax is constitutionally under the jurisdiction of the provinces and territories. The responsibility of provincial and territorial governments relates to fundraising, corporation registry, gaming and lotteries, and other activities.

215. In 2009, the Canadian Government enacted the Not-for-Profit Corporations Act 2009 which aims to promote accountability, transparency and good corporate governance for the NFP sector in the same way as the for-profit sector.

216. A NFP organisation is broadly a club, society or association that is not a charity and is organised and operates exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit.
217. Even though most of these organisations are exempt from income tax, they are still required to complete an income tax return each year to the CRA. Some NFP organisations may be required to pay tax on income from property.

## ENDNOTES

- 1 Productivity Commission Report, Contribution of the Not-for-Profit Sector, 2010, p 3.
- 2 *ibid.*, p xxvii.
- 3 *ibid.*, p xxvii.
- 4 *ibid.*, p xxv.
- 5 *ibid.*, p xxv.
- 6 *ibid.*, p xxvii.
- 7 *ibid.*, p 37.
- 8 *2009 Tax Expenditures Statement*.
- 9 Productivity Commission, p 54.
- 10 Various Commonwealth, State and Territory budget sources.
- 11 DEEWR, Financial Report of Higher Education Providers.
- 12 Productivity Commission, p 72.
- 13 *ibid.*, p 53, note: this figure is based on 2006-07 data.
- 14 2007-08 Taxation Statistics, ATO.
- 15 *2009 Tax Expenditures Statement*.
- 16 *ibid.*
- 17 2007-08 Taxation Statistics, ATO.
- 18 Australian Bureau of Statistics, catalogue number 5206.0, (<http://www.abs.gov.au/ausstats/abs@.nsf/Products/DD086A90C171B98FCA257800000E672A?opendocument>).
- 19 2010-11 Budget, and *2009-10 Final Budget Outcome*.
- 20 2010-11 Budget.
- 21 Statement of Finances: 2010-11, Table 5.4: Aggregate tax expenditures (excluding thresholds) classified by persons or entities affected, [http://www.budget.vic.gov.au/CA2576BD0016DD83/WebObj/BP4Ch5/\\$File/BP4Ch5.pdf](http://www.budget.vic.gov.au/CA2576BD0016DD83/WebObj/BP4Ch5/$File/BP4Ch5.pdf). The following items were added together to produce the quoted figure: charitable organisations, educational institutions, hospitals, religious institutions, and sporting, recreation and cultural organisations.
- 22 National Roundtable of Non profit Organisations, The assessment of charitable status in Australia: current practice and recommendations for improvement Submission 170 to the 2008 Senate Inquiry into Disclosure regimes for charities and not for profit organisations (2007), 1.
- 23 Productivity Commission, p 169.
- 24 <http://www.charity-commission.gov.uk>.
- 25 Productivity Commission, p 169.
- 26 Productivity Commission, p 58.
- 27 Productivity Commission, p xvii.
- 28 <http://www.charities.sa.gov.au>.
- 29 Philanthropy Australia, David Ward, Trustee Handbook: Roles and duties of trustees of charitable trusts and foundations in Australia (2008), p 8.