

Regulation for Not-For-Profit Sector in the 21st Century



**Centre for Social Impact
Research & Policy Conference
Regulation for Not-For-Profit Sector in the 21st Century*
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The Centre for Social Impact, University of New South Wales, hosted two sessions for this research and policy conference. The first was research workshop held on Thursday, 21 July 2011, with limited attendance to invited academics and several invited international guests. The emphasis here was on the presentation of research, largely from the discipline of economics, which could have some bearing on the issue of what would be an appropriate means of regulating or monitoring the not-for-profit sector in Australia. This was followed by a Research and Policy Conference held on Friday, 22 July 2011 that was more broadly attended by academics, policy makers, and leaders from the nonprofit sector.

Now some background. In January 2010, The Productivity Commission of the Australian Government published its Research Report, *Contribution of the Not-For-Profit Sector*. Among the key points in this report were the following: (1) current information requirements imposed on NFPs for funding and evaluation purposes are poorly designed and unduly burdensome, and reform is needed to meet best practices principles; (2) the current regulatory framework for the sector is complex, lacks coherence, sufficient transparency, and is costly to NFPs; (3) legislative proposals to reduce reporting burdens associated with companies limited by guarantee are welcome and needed if more NFPs are to adopt Commonwealth incorporation; (4) implementation of government and sector reforms will be best facilitated by a central policy and implementation unit within the Australian government, such as through the establishment of a specific Office for NFP Sector Engagement.

Although the report noted that the sector had experienced positive developments in recent years, there were issues that restricted the sector's ability to improve its efficiency and effectiveness and fulfill its potential. According to the report, many would argue that the current requirements regarding accountability, such as, audited financial reports, business plans, and demonstrable results, are not appropriate, impose compliance costs without commensurate benefits, and are lacking a sense of proportion in regard to the size of the organization or scale of its undertaking. Also, cross-jurisdictional differences impose unnecessary burdens.

The recommendations promoted by the Commission were: building knowledge systems which included a national data system on the NFP sector and a better evidence base for social policy; and establishing smarter regulation for NFPs, including a “one-stop-shop” for Commonwealth regulations consolidating various regulatory functions into a new national Register for Community and Charitable Purpose Organisations. This new Register would, *inter alia*, register itself and would provide for the regulation of NFPs, assessing their eligibility for NFP organizations for Commonwealth tax concessions and endorsement, provide a single reporting portal for public record and financial information, provide appropriate regulatory guidance in relation to governance matters, and provide for the investigation of compliance with regulatory requirements. There were also recommendations relating specifically to improving the effectiveness of direct government funding and removing impediments to better value government funded services.

In January 2011, the Australian Assistant Treasurer and Minister for Financial Services and Superannuation issued the consultation paper as part of the scoping study for a national not-for-profit (NFP) regulator. In its introductory statement setting out the Stakeholder Consultation, we read that: “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.” The Consultation Paper attempted to discuss what it called the features of a best practice regulatory framework and to seek stakeholders’ views regarding the goals of a national regulation, the scope of a national regulation, the functions of a national regulation, and the form a national regulator.

As the scoping study noted, the government provides significant support to the sector in recognition of the vital economic and social role it plays. Moreover, the scoping study also noted that:

In addition, the Australian Government and State and Territory governments provide a range of generous tax concessions to eligible NFP organizations, including: an income tax exemption; deductible gift recipient (DGR) status; refundable franking credits; and fringe benefits tax, goods and service tax (GST), land tax, payroll tax and municipal rates concessions.

According to this consultation paper, the government provides these taxation concessions because it values the contribution the sector makes to the welfare of the wider Australian community. Because these “concessions are taxpayer funded,” and as a result, “NFPs are in receipt of taxpayer monies,” there needs to be a high level accountability flowing back to the public. This means that reporting as one such accountability measure could be improved.

Noting that recent trends indicate higher levels of governance and accountability for both the for-profit and government sectors, trends to improve governance and accountability have not extended to regulation of the NFP sector according to this consultation paper. Accordingly, there are sound reasons for governance and accountability reform in the NFP sector. The scoping study then reported on international developments over the past decade. According to the study, there had been significant reform of the regulation in the NFP sector over the last decade. In countries which were federations, similar to Australia, *i.e.*, Canada and the US, the regulations have been set up within the tax authorities. In non-federal countries, such as, the UK, Wales, Ireland, Scotland, and New Zealand, Charity Commissions (or in Scotland, where there is the Scottish Charity Regulator, and Ireland with its Charity Regulatory Authority) have been established with roles of providing guidance to registered charities, ensuring charities are accountable and meet their legal obligations, and maintain an online register.

There is much more in the scoping consultation paper that could be discussed, but will be reserved for a future post. But, what is important for my purpose here is to set out something of a context for this Research Symposium, and for the Research & Policy Conference that followed.

**RESEARCH SYMPOSIUM
21 JULY 2011**

Prof. Dr. Andreas Ortmann (UNSW): *Regulation, Self-Regulation, Accreditation and Certification: What We Know, What We Don't Know, and What We Ought to Know.*

The issue in this symposium and in this presentation is one of credibility. The issue, specifically, is: how to make sure that public (state funding) and private donations go to the causes for which they are intended where the goods or services are, in economic terms, credence goods? Credence goods are goods whose quality cannot be ascertained immediately, or at a reasonable cost. Third sector goods and services are rarely what economists call search goods or services whose quality can be ascertained immediately at reasonable costs.

Credence goods and services generate information asymmetries that can be exploited through fraud, mismanagement, or mission creep. So, the question is how to determine whether nonprofits spend their monies efficiently and as promised.

Addressing fraud, mismanagement, and mission drift is important because trust and reputation are what keep public funding and private donations, including gifts-in-kind, and volunteer services contributing to the purposes of the charitable organizations. A recent example is the scandal involving Central Asia Institute and the selling of the book, *Three Cups of Tea: One Man's Mission to Fight Terrorism and Build Nations*.

Three Cups of Tea describes the transition of Greg Mortenson from a registered nurse and mountain climber to a humanitarian committed to reducing poverty and promoting the education of girls in Afghanistan and Pakistan. Mortenson became a co-founder of the Central Asia Institute, a nonprofit organization that claimed to have built 171 schools and providing education to over 64,000 children, primarily girls, in remote regions of Afghanistan and Pakistan. In April 2011, CBS News broadcast its *60 Minutes* program in which it reported alleged inaccuracies in the book, and its sequel, *Stones into Schools: Promoting Peace with Books, Not Bombs, in Afghanistan and Pakistan*, and financial improprieties in the funding and operation of the Central Asia Institute. It appears that many of the stories in these books were false, and that Mortenson was personally enriched by the sales of the books and monies received by the charity, notwithstanding its status as a tax exempt organization in the US and its high rating by an independent charity organization.

The Productivity Commission (2010) in Australia found that there was a lack of evaluation criteria for the sector in Australia with which there was any agreement, and further, that the regulatory framework was complex, lacked coherence and sufficient transparency, and was costly to NPOs. Although the Productivity Commission called for a registration system for NPOs, its proposal lacked detail on what a measurement and evaluation framework should look like and the Commission appeared ignorant of what was going on elsewhere in the certification movement for NPOs.

As a result of the Scoping Study, or consultation paper in January 2011, the Government in May 2011 proposed a Not-For-Profit Sector Reform Council to establish a new regulatory system. Essentially, Australia seems to be heading toward a regulatory system that is primarily responsible for registration of charities eligible for tax exempt status and other conditions. The question is whether such a system is sufficient, or good enough, or whether there are alternatives, such as reputation, self-regulation, accreditation, certification, that should be considered.

A system based on reputation is inadequate because it invites strategizing with self-reporting, bias, and politicking. Thus, evaluation and reputation in areas such as popularity of lectures or professors in the university, or hospital, or university based on certain ranking criteria, reflect certain biases, frequently presented in the self-reporting model. However, were the reputation is based on systematically provided data, it may be preferable to that which is based on self-reporting. Nevertheless, the more idiosyncratic the service, the more unreliable reputational enforcement becomes.

Regulation which is largely based upon and limited to registration is widely required by law around the world, whether or not there are tax considerations applied to the NFP organization or donor. The focus is primarily on compliance with the tax laws with respect to public benefit and compliance with certain minimal requirements. Such a regulatory system is foundational, but not sufficient, quoting van Broekhoven and Kemps, 2011. OSCE Electronic Journal,

We have seen no evidence that a regulatory system imposed by the government instead of regulatory schemes imposed by independent watchdogs increased transparency and accountability of the NGO, and if it did, that it increased the level of trust between donor and NGO thereby increasing the level of giving.

Furthermore, the Australian registration system tends to be too complex and lack coherence. Compliance and reporting requirements impose significant costs; the trend has been for a growing compliance burden; the compliance burden is disproportionate to the risks involved and funds received; reporting requirements often appear to serve no worthwhile purpose; and lack of consistency and duplication add to the compliance burden. The US Internal Revenue Service system is based on self-reporting with insufficiently based verification. For example, just this year, the IRS revoked the tax exempt status of 20 percent of registered tax

exempt organizations. For the most part, these revocations were the result of charity organizations failing to file their informational tax return for three consecutive years.

Will a "national one-stop-shop regulator" or registrar take care of the problem of bureaucratic red tape? Probably not because it will be based on self-reported, insufficiently verified data. *See presentation of Dr. Lana Friesen.*

To solve the credibility problem, a sufficient condition must include an assessment of membership and responsibility of governing board, fulfillment of public benefit goals, fiscal control and management, fundraising practices, and provision to public of information, such as disclosure of audited financial statements. A form of self-regulation by observation, and perhaps by third party, is rarely truly independent. Again, quoting from van Broekhoven and Kemp, Ortmann pointed out that:

Important to the satisfaction of these standards is the goal of ensuring that the public, donors and recipients of public benefits, have ready access to sufficient and adequate information to enable them to make informed decisions about the organization, their relationship to the organization, and the accountability of funds raised by the organization. Standards, without monitoring, provide little assurance to the donor regarding the transparency, integrity, and governance of charities and other public benefit non-governmental entities.

There is a debate in Australia regarding accreditation models, except with respect to the health service providers. In the US, according to Ortmann, the accreditation model for colleges and universities has been discredited, particularly when based on numbers of graduates, and performance or success rates of graduates.

Certification schemes did not exist in the US until quite recently, except in the case of ECFA. Now, BBB Wise Giving Alliance, and Maryland Association of Nonprofits, which is replicated in a number of states, are models of certification. The ICFO members, including CBF, DZI, ZEWO, ECFA, CCCC, and Taiwan NPO Self-Regulation Alliance are examples of how certification models can be effective. It is interesting that the ICFO members display: widely divergent organizational solutions; widely divergent investigative practices; widely divergent pricing strategies; widely divergent methods of financing; and widely divergent successes.

What we ought or need to know is the extent to which fraud and mismanagement exist in the third sector. According to the NCVO "Managing Risk" report of 2011, There is a perception that the charitable sector's altruistic nature makes it a "soft target" for fraudsters. In reality most of what is known comes from anecdotal evidence. ... Over the past couple of years a number of surveys have tried to fill in this knowledge gap

[T]he most recent assessment of fraud loss in the charitable sector, which is provided by, the National Fraud Authority's "Annual Fraud Indicator" estimates that total lost turnover for the sector is around £ 1.3 billion a year. ... an average of 2.4% of charities annual turnover. ... The estimated £ 1.3 billion figure captures fraud against charities (for example fraud perpetrated by employees and/or volunteers, or fraudulent applications for grants and/or financial support) as well as some of the financial impact that fake or sham charities have on legitimate charities.

Other statistics seem to suggest that there is less fraud in recent times than previously. However, the problem with these kinds of survey-based statistics is that it is quite likely that there is a high incidence of unreported cases, and it is difficult to figure out what is fraud vs. mismanagement vs. mission drift.

According to Ortmann, there is a lot of interesting work to be done by researchers, including theoretically, empirically, and experientially. For both policy makers and advocates for the third sector, insights can be gained by looking at what is being done elsewhere, and through the cross fertilization of ideas, practices, and successes and failures. This is one of the strengths of ICFO and its national member organizations.

Prof. Dr. Uwe Dulleck (QUT): *The Economics of Credence Goods and the Role of Certification.*

The need for certification implies asymmetric information. That is, some stakeholders (donors) cannot observe whether or not the organization is performing as promised. Therefore, there is the need for experts to observe and verify performance.

“Standard” goods, are good with a well-known or standardized quality or characteristics. One knows what they are and where to get them, and there are no transaction costs. Examples from the market include petrol, milk, or

bricks, for example. “Search” goods, are those which can be observed, but one must observe the goods before buying. “Experience” goods have unknown qualities that are determined only after buying and using them. Examples would include electrical appliances, tools, or wine, for example. Standard, search, and experience goods do not require an expert to advise the buyer or stakeholder since the buyer or stakeholder knows what he or she is getting without such advice.

“Credence” goods, on the other hand, are those which the buyer does not know either before or after purchase. As a result, an expert knows what is needed before the purchase, and whether it will satisfy the needs of the purchaser or stakeholder. Examples include medical doctors who perform the diagnosis, prescribe the treatment, and perform the services; or mechanics who tell the automobile owner what is needed for the repair of the automobile and provides the service.

There can be problems with these experts as a result of their misdiagnosis, the treatments they prescribe, and the fact that the buyer or client or stakeholder does not have the required expertise to determine the need or quality of the treatment of performance.

There are four basic assumptions that one can make about credence goods. The first is homogeneity, or the idea that all consumers have the same probability have having the same major problem, and the same valuation. The second is the assumption of commitment where once the recommendation is made the customer is committed to proceed with the treatment. The third is the assumption of liability where the expert cannot provide the cheap treatment if the expensive treatment is what is really required. The fourth assumption is the assumption of verifiability where the expert cannot charge for expensive treatment if he or she provided cheap treatment.

In the case of credence goods, and assumptions regarding commitment, homogeneity, and liability or verifiability or both, market institutions solve the fraudulent expert problem without cost. Different results are obtained with variables in each of these assumptions.

Certification and credence goods lead to some problem areas and questions that need to be addressed. For example, what are the incentives for profit oriented certifiers? Profits, or enhanced reputation, may lead to biased reporting. Easy passes or easy and clean reports may lead to increased business or enlarged membership roles. When there is a certification process that may be dependent on outside experts, such as auditors or consultants, these experts will provide the service for a profit. Good or truthful reporting may lead to “abuse by rating agencies” later on. This may occur when the certifier has a good reputation for high standards, but then accepts or certifies an organization on the basis of lower standards, especially when the quality of service is not observable. Inflation of ratings may occur if consumers or followers of reporting act strongly against honest ratings or if the cost to reputation of inflation of ratings is low.

Based on the forgoing research and experimentation, according to Dulleck, there are conclusions that might be expected in the case of certification of nonprofit organizations. Incentives of any expert certifier need to be considered. Given that the true quality of an organization is likely to be always revealed, the strategic or profit maximizing motive and behavior of the certifier will play an important part in the certifying role. This implies that the strategic behavior of certifiers may be a barrier to entry on the part of nonprofits into the market, or segment of the market, since some certifiers may tend to be negative in reporting outcomes to avoid being regarded as incompetent.

Prof. Dr. Lana Friesen (UQ): *Dishonesty in the Laboratory (and its Policy Implications): Economic & Intrinsic Motivation for Dishonesty.*

The purpose of the study on which she reported was to measure the incidence of dishonesty in different settings and to explore the different incentives for honesty/dishonesty. Honesty is essential for many financial transactions. Yet there is evidence of the high cost to society of dishonesty. Studies have demonstrated that dishonesty is rife in American Society, and that fraud is the most expensive crime in Australia.

Dishonesty is defined as the disposition to deceive, defraud, or steal. It encompasses a broad range of acts from providing false information to more direct forms such as stealing or theft of property or equipment. The economic experiment here involved the study of two broad categories of dishonesty in individual decisionmaking. The first was direct theft task with more direct forms of dishonesty. The second was reporting task where the dishonesty occurred in the reporting activity.

Self-reporting is a tool commonly used in regulatory enforcement. Self-reporting maybe either compulsory (periodic mandatory reports) or voluntary (where there is an incentive for self-reporting). In the experiment, there was a 100 percent incidence of accidents. More reporting of violations was likely to occur where there was mandatory reporting than when there was voluntary reporting because of the aversion to telling outright lies.

The experiment involved all participants performing two tasks: theft task, and reporting task. In the theft task, they paid themselves real money for performance of certain tasks. In the reporting task, they were paid according to the decisions they made in their self-reporting of accidents which occurred. In the theft experiment, 33 percent of the participants were dishonest, with 26 percent of those taking the maximum amount of money that they could have taken, and 42 percent taking a significant amount of money. In the experiment measuring dishonesty in the reporting task, only 15 percent of the accidents that occurred were reported, and 47 percent of the participants never reported any accident. Only four percent reported all the accidents that occurred. There was a significant difference in the reporting between those who reported voluntarily as distinguished from those that reported because of compulsory reporting requirements.

What the experiment demonstrated was that there was substantial dishonesty in both tasks although the incidence of dishonest varied substantially across both tasks. Whereas, a third of the participants in the theft task were dishonest, virtually all the participants in the reporting task were dishonest, with a higher rate of dishonesty in the case of those that reported voluntarily.

The implications for nonprofit sector of this study are: (1) A significant minority of people are willing to be overtly dishonest, and some, to maximum extent. (2) Almost everyone may be prone to be dishonest in certain situations, especially in the case of organizational narcissism when outcome reporting and where findings are involved. (3) We should be cautious about using self-reporting when enforcement is weak.

Prof. Dr. David Greenfield: *Health Service Accreditation as a Predictor of Clinical and Organizational Performance; Accreditation Issues for Consideration.*

The prevalence of accreditation since the 1970s is due to a shift in philosophies of governments that provide for a framework for services, abatement or control of risks, and is part of a broader regulatory strategy. It is part of a strategy to produce quality, *i.e.* civic minded with the intent or desire to do the right thing, education, competition/consumer behavior, aspirational codes, enforced codes, mandatory general laws, and specific laws.

In Australia, accreditation in the healthcare is “responsive regulation” where the regulators are responsive to context, culture, and conduction of those being regulated. Accreditation involves the application of national and internationally agreed to standards for assessing and benchmarking performance. It is a peer led focus. Performance and environment are continually changing, shaped by development of organizations, updating of practices, and expectations of professionals and community. As a result, there is a continual need for evolving and updating accreditation standards and practices.

An examination of eight inquiries into patient safety identified a number of common themes. First, some health care was far below quality. Second, quality monitoring processes were deficient. Third, individual health care providers and patients raised concerns. Fourth, critics were often ignored or abused. Fifth, teamwork was deficient. Sixth, patients and families were not informed members of the team. All of this pointed to risks in accepting individual self-assessments.

The key question is: What is the aim of an accreditation program in health care? It is to improve the quality and safety in health care.

So, what are the potential benefits/costs for a peer review accreditation program? First, it promotes quality. Secondly, it promotes professional standards and norms. Thirdly, it promotes professional development standards. Fourthly, it provides for enhancement of networks within the profession and sector. Fifthly, it provides for the spread of information and evidence. Sixthly, it promotes the enhancement of a community of practice. However, it also takes time and involves the cost of self-study and for covering the accreditation process, and in can be a threat to professional autonomy.

In the University of New South Wales study of accreditation, there were 14 standards applicable to organizational functions, which included continuum of care, leadership and management, human resource

management, information management, safe practice and environment, and improving performance. Accreditation standards covered 43 criteria, 19 which were mandatory, and 24 non-mandatory. The accreditation process involved a self-assessment against the 43 criteria, a survey-assessment by peer reviewers, and a survey report. For the qualitative methods utilized, the assessment findings appropriately strove credible and verifiable. Although the results were not precisely repeatable, the aim was to be rigorous as possible, transparent, and defensible.

One research aim of the research project here was to explore the relationships between accreditation, clinical performance, organizational culture, and consumer participation. One of the questions here is why accreditation been effective in health care? If healthcare facilities are not completing accreditation programs, how can they demonstrate efforts to improve safety and quality?

The second aim of this research project was to examine the influence of surveyors on both the accreditation process and outcome, and on their own healthcare organizations. Here the critical issue was reliability. Reliability of assessments is a challenge to many industries, including academia, management, agriculture, and healthcare. The studies here caused the team to rethink its assumption that reliability of outcome was the right notion to be investigated. Instead, the team concluded that the reliability of process and consistency in the application of standards were, more accurately, the outcomes to be pursued.

The ability to make judgments in an accreditation process is almost impossible because there are always differences of opinion by the members of the survey team. It is important to be realistic about the ability to make judgments against criteria when judgments have subjective elements. Thus, factors that promote reliability include: peer-based review, a defined assessment program, collective training, appropriate management and leadership, and ongoing assessment of the surveyors.

In the healthcare sector, insurance companies want a proximate measure of quality. Municipalities and political entities want assurance of quality. And media is driven by its investigation and reports on the quality of healthcare service.

Context is important. There are different ways of addressing accreditation. But, a key question should be: what is the aim of a particular accreditation program?

Les Hems: *Centralised Versus Distributed Systems of Regulation and Certification.*

The issues here related to the building of a regulatory system. Is there a need for regulation, and if so, why? Two reasons might be to protect the interests of citizens, and to assist the functioning of the markets. What might be missing here in the discussion was what interests required protection and how the markets functioned better as a result of some kind of regulatory system.

Within the civil society sector, the charities, the not-for-profits, associations, clubs/societies, and community organizations, as well as social enterprises were among those entities that would be regulated. But, then there is the issue as to what societal roles and functions were to be regulated? These might include service providing organizations, campaigning/advocacy groups, and grantmaking organizations.

In building a regulatory system, who are the stakeholders and what are their expectations? And, do we really know what the stakeholders' expectations are in relation to the role and operation of not-for-profit organizations and charities. Stakeholders include the general public, donors and funders, beneficiaries, clients, members, and managers and directors (as well as employees) of the NFP organizations. Assuming that there are different expectations for different categories of stakeholder, can these expectations be aligned or are the competing? Then there is the question of how to measure expectations (performance) and what metrics should be applied. How can performance be communicated, an especially important question when there is emphasis on impact measurement, and what signals prompt stakeholders' response.

In building a regulatory system, the nature of annual reporting would include Financial Reporting Standards, Audit and Assurance Standards, such as those of Centraal Bureau Fondsenwerving (CBF), the UK Charity Statement of Recommended Practices (SORP), Social Return on Investment/Impact Statements, and International Integrated Reporting. Moreover, the nature of regulation should include the roles of self-reporting and self-regulation, the roles of accreditation and certification, and the role for formal government regulation.

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The studies presented by Drs. Andreas Ortmann, Uwe Dulleck, Lana Friesen, and David Greenfield, as well as the Centre for Social Research, UNSW, Director of Research, Les Hems, were presented again in the policy forum on 22 July 2011 as a prelude and to provide the background for the case studies and policy considerations for a regulatory regime for not-for-profit sector in the 21st century. The presentation by Dr. David Greenfield was the Case Study 3.

Trevor Garrett: *Case Study 1: New Zealand Charities Commission.*

The Charities Commission was established in 2005 to register and monitor charitable organizations in New Zealand. As such, it is an autonomous Crown entity.

Many charities are an invisible part of the economy. The Charities Commission in New Zealand serves three major functions: education, registration, and monitoring compliance and investigating claims of noncompliance. To be more specific, its functions include: promoting public trust and confidence in the charity sector, encouraging and promoting the effective use of charitable resources, educating and assisting charities in relation to matters of good governance and management, considering and deciding on applications for registration as a charitable entity, compiling and maintaining a registry of charitable entities, monitoring charities to ensure that they remain qualified for registration, and inquiring into charities that may be involved in serious wrongdoing.

The registration requirements include the submission of the application for registration, together with the rules and the identification of officers. Annual registration renewals are required with the annual financial statements. Charities are also required to notify the Charities Commission of any changes in the organization. The open data – transparency project provides for charity register and access to charity data through the Internet. There is also an advanced search option which is designed to help charities and individuals query the Register’s data in a more complete and complex way than a simple Registry search.

The main stakeholders are the public, the charities, and the government. Commission outputs include monitoring compliance, advising, educating, and providing information to charities, and advising and providing information for government reflect a higher degree of direct influence by the Charities Commission. Charitable outcomes are that the public is better informed about registered charities, charities are compliant and have the required knowledge and incentive to meet the requirements of the Charities Act, and the government is better informed about the charitable sector and the needs of the public in supporting charities. A stronger, more effective charitable sector involves responsive government policy to the needs of charities and the needs of the public in supporting charities, effective governance and management of charities with proper use of charitable resources which are used effectively and efficiently for the intended purpose, and informed decisions on the part of the public where the public has trust and confidence in the charitable sector.

Although not directly addressed in the research presentations and conference reports, the use of the word, “charity,” has not been free of ambiguity. This was addressed here where there was a recognition of a disconnect between the legal and colloquial meaning of the word, “charity.” Thus:

The terms of s. 5 make it clear that the term “charitable” is used not in its ordinary dictionary meaning but in the particular technical meaning that the law has ascribed to the word. The usual starting point for a consideration of that technical meaning is the preamble to the Charitable Uses Act 1601, often referred to as the Statute of Elizabeth 1. The preamble, with its list of charitable purposes, came to form the basis for decisions of the Courts as to what was or was not charitable, so that a technical meaning, wider than the ordinary usage of the word, has evolved.

Under existing case law, if the Charities Commission declines the registration of an organization, it must state the reasons for doing so. The challenge is publishing the decisions in understandable language so all can read and understand the basis for the decision.

The Charities Commission’s monitoring and investigative activity results from the complaints filed with the Commission, or from external sources, in which anyone has been alleged to have been engaged in conduct in breach of the Charities Act or serious wrongdoing in connection with a registered charity. Thus, complaints may relate to internal conflicts, the quality of financial statements, non-compliance with the rules, sub-optimal

decisionmaking, fraud and criminal content by officers, hostile takeover bids, vote buying, private pecuniary gain, and non-charitable activity. Since June 2009, there have been 835 investigations, of which 20 percent were as a result of complaints submitted from the public, 5 percent as a result of monitoring of media, 25 percent as a result of referrals from within the Commission, 5 percent from government agencies and funders, and 10 percent resulting from the review of annual returns.

The Charities Commission is making a difference through its registration of charities (more than 25,000 charities registered), its provision of information regarding charities which has promoted transparency, its activity in monitoring and investigating complaints of noncompliance with the law and other serious wrongdoing, and its educational programs and forums.

Daniel Zuccarini: *Case Study 2: State Government Regulation of Fundraising.*

The New South Wales Government Office of Liquor, Gaming and Racing provided the case study for state regulation of charity. The objectives of the fundraising legislation were to promote proper and efficient management and administration of fundraising appeals for charitable purposes, to ensure proper record keeping and auditing of records and accounts in connection with fundraising appeals, and to prevent deception of members of the public who desire to support worthy causes.

The role of the New South Wales Office of Liquor, Gaming and Racing is to ensure that persons conducting fundraising activities are operating in accordance with the law. It does so by granting authority to individuals and organizations to raise funds, by providing educational programs, and by undertaking compliance programs. According to my understanding, the emphasis appears to be primarily on the actual fundraising activity or solicitation of funds, rather than the broader area of the governance, management, and accountability of the organization raising funds, which were the areas that seem to be addressed in the Productivity Commission Research Report or in the Scoping Study or Consultation Paper.

An authority to raise funds must be issued before an organization or entity is able to lawfully conduct fundraising from the public in New South Wales unless the organization is exempt. Exemptions include religious or government controlled organizations. Moreover, although the conditions for fundraising are flexible and may be modified, organizations holding authority to conduct fundraising must comply with the Authority Conditions. The Office of Liquor, Gaming and Racing specifies the rate of return on fundraising appeals, such as a minimum of 50 percent for cash or donation appeals, 40 percent from raffles, 30 percent from art unions, 12.5 percent from House, and fair and reasonable proportion of gross proceeds from other appeals.

The principle is that charities are supported by donations and the public should have confidence that its donations are applied to the purposes for which they were solicited and intended. Therefore, the Office of Liquor, Gaming and Racing have the powers of inquiry where there is misconduct and wrongful use of funds and assets, mismanagement is suspected, and noncompliance with the law is suspected.

Sanctions for mismanagement or misconduct include prohibition of further fundraising, the imposition of special conditions, the appointment of an administrator, and prosecution.

In addition to the principles and rules regarding the actual practice of raising funds, the Office of Liquor, Gaming and Racing, applies standards of accountability and record keeping. These include the requirement that accounting records must be kept for seven years, that all money received in the course of a fundraising appeal must be banked immediately, without deduction, and that all expenditures be supported by documentary evidence, including evidence that they were properly incurred and authorized by the committee. Similarly, all assets must be recorded. Annual audited financial statements are required except with respect to organizations that raise less than \$100,000 p.a. unless they are submitting renewal applications or when requested.

Additionally, there are requirements or standards with respect to the responsibilities of the governing body, and access to information, such as audited financial statements, extracts from objects and constitution, and names and occupations of members of the governing body.

Adri Kemps: *Case Study 4: Certification of Fundraising in the Netherlands.*

In this Case Study 4, The Netherlands is presented as a model, from a European perspective of independent oversight on fundraising. The Centraal Bureau Fondsenwerving (CBF) was established as an independent

foundation in 1925 to gather and publish information on fundraising organizations in order to protect the interests of donors and charities.

In 1958, CBF became one of the founding national members of the International Committee on Fundraising Organizations (ICFO). ICFO is an international umbrella organization or association comprised of 13 national monitoring organizations which are members of ICFO and four other organizations associated with some level of monitoring and interest in advancing independent monitoring of public benefit organizations which are supporting members. Additionally, there are emerging and functioning monitoring organizations in Cambodia, China, India, Indonesia, Mexico, and the Philippines with which ICFO is working. We believe that NPOs, fundraising and charity work are important elements to strengthen civil society and accountability.

Since 1965, when the income raised by CBF registered charities was the equivalent of less than €100 million, in 2009, the income raised by charities was approximately €1.3 billion. Of that amount, approximately 38 percent was dedicated to international development, 13 percent to health, 34 percent to culture and social welfare, and the remaining 15 percent to nature. There is increasing emphasis in the Netherlands by the Dutch government to increase the level of charity giving to social welfare.

As in many parts of the world, the issue is one of independent monitoring, which is regarded as the third way. State regulation is largely characterized by registration and some level of fiscal oversight. In some countries, such as Italy and the Netherlands, the Chamber of Commerce maintains the records with basic information in a registry which is open to the public. In the United Kingdom, the Charity Commission keeps the registry, whereas in Belgium, France, and Germany, registration is maintained by the district courts. These registration authorities vary in their registration requirements and what information must be available to the public.

There is also self-regulation which is done by the sector or some portions of the sector. Here there are codes of conduct issued by umbrella bodies, capacity building, and some form of requiring and promoting transparency.

Independent monitoring is the third way for promoting accountability. Here, independent monitoring is often characterized by the granting of a seal of approval (or recognition of accreditation) by an independent agency, and what is known as donor advisory by some independent watchdog group or organization.

In the Netherlands, CBF registered approximately 1,350 NGOs and maintains the website in which data on the NGOs is maintained, which serves as a knowledge centre with a data base, report on fundraising, and digital newsletter. CBF grants seals of approval to 272 charities, of which 77 are certified small charities, and provides statements of no objection for start-up charities. Additionally, CBF performs annual monitoring and conducts on-site visits, and audit reports which are used by the government and media.

As in the case for most of the ICFO member national organizations, CBF follows a practice of monitoring NPOs against certain standards. These standards cover fundraising practices (based on principles of truthfulness, accuracy and currency of information, and avoidance of manipulative pressure on donors), finances (with requirements for audited financial statements, limits on fundraising and administrative ratios, control systems on expenditures, and disclosures of financial reports), and governance (where the focus is on the functioning of planning and supervision of the organization, on effectiveness of its programs, and transparency of its operations as well as salary structures).

There are trends in the sector that are interesting to watch and consider how they will affect the monitoring of the sector and accountability. The first is trend toward quality measurement, or impact or effectiveness of the charitable activity. For reasons beyond the discussion here, this does not seem to have really caught on except perhaps in the case of major donors and philanthropists. CBF does not require reporting of effectiveness or impact measurement. The second trend is to establish limits on administrative and fundraising costs. What we are seeing is that both state regulation and the articulation of standards are trending toward specified ratios, such as fundraising costs cannot exceed 25 percent of the donated income. The third trend is greater use of professional employee within the monitoring organizations and less reliance on volunteers.

There are certain strengths and weaknesses associated with state regulation. First, it is important to understand that charitable activities and civil engagement are voluntary and private acts of people. Therefore, state involvement in regulating these activities should be restricted less this voluntary engagement, motivation, and private activity is diminished.

Second, the state can protect and support civil engagement through prosecuting criminal conduct and criminal abuse of charitable organizations. However, further “regulation” and monitoring should be left to independent monitoring organizations and self-regulation initiatives, an idea in the best sense of the concept or doctrine of subsidiarity.

Third, state authorities are generally not competent or accustomed to the nature and role and character of public benefit activities, their dynamic development, and the motivations and mentality of their leaders. Therefore, a great deal of state regulation carries the risk of being inadequate, or worse, disproportionate, to the problem the state seeks to address, or conform to its own value set.

On the other hand, the strengths and weaknesses of self-regulation and independent monitoring are found in the nature of the third sector. A strength of self-regulation is the voluntary acceptance of a code of conduct by those who are part of the group submitting to the reputation of the group through the acceptance of such a code of conduct and compliance with that code through accountable practice. The weakness is that the monitoring of compliance is dependent to a large extent of self-reporting. However, self-regulation can lead to a culture of transparency and accountability in the third sector as well as improvement of the sector’s processes and practices through capacity building. Nevertheless, in order to build on, and enhance donors’ trust, as well as the trust of the general public, self-regulation needs to be complete and complimented by independent monitoring.

Hon. Rollin Van Broekhoven: *Review of Fundraising Certification Initiatives Across the Globe; Challenges to Accountability.*

Several years ago there was a survey of the number of articles published in the news media about the nonprofit sector, and specifically, the kind of attention charities were getting in the public arena. The key subjects of alleged problems with NPOs covered in these articles were: board governance (129 articles), legal investigations (70 articles), conflicts of interest (61 articles), executive compensation (60 articles), extravagant spending (60 articles), and fundraising practices (45 articles). There were an additional 43 articles in which the subjects were an unwillingness on the part of a particular NPO to be open and transparent in responding to requests, poor quality of audited financial statements, the failure to stay current with changes in the law, failure to follow the organization’s own bylaws and policies, improper allocation of fundraising and overhead expenses, and the use of restricted funds for operational purposes. Most of these could be attributed to some failure with respect to board governance, although there was a separate category for that.

Almost immediately when there is a reported “scandal” in the news media, or what we might call “an odor piscatorial,” in the third sector, there are immediate calls for legislation, or some form of state regulation of the sector.

The statutory scheme and regulatory regime are almost always the same: periodic and regular reviews of tax exempt status of the NPO; revocation of tax exempt status for accommodation to tax shelters; increased sanctions for self-dealing of alleged improper investments; establishing standards for government review of alleged conversion of tax-exempt organizations to for-profit organizations; delegated authority to states to pursue federal actions against NPOs for violating federal tax laws; improving the quality of informational tax returns and financial statements, often with requirements that have little to do with the alleged shortcomings in the reporting; penalties for failure to timely file informational tax returns, required disclosures on tax returns and websites of the application for tax exempt status and determination letter from the tax authorities; detailed specifications on governance policies, including board make-up and board member duties; etc. All because someone thought that there was something wrong that needed to be corrected by the heavy hand of government.

The adequacy of the model frequently followed is subject to question. The model is this: Some authoritative body, such as the state, establishes rules regarding the type of information to be disclosed, based on the state’s value set, and not on some universally binding moral principles. Secondly, accountability requires disclosure of specific information to designated individuals or entities, such as the state. Third, accountability is generally confined to information regarding the process of accounting for funds and whether or not the NPO complied with certain processes or procedures in accumulating and reporting fund received and expended.

Except with respect to certain tax related information, there is little accountability, if any, required of the organization not submitting itself to accountability and monitoring, which represents the vast majority of NPOs.

There are a number of challenges to thinking about accountability that effect whether there is a centralized state imposed regulation, self-regulation, or independent monitoring. One of the challenges is simply the matter of language and definition. Jargon and cliché, euphemism, question-begging, and cloudy vagueness are deadly enemies of healthy political life and civil society. So, for example, “transparency” and “accountability” are examples of such words that have, or are becoming devoid of any meaning.

A second challenge is that of postmodernity and postmodernism, where doubt is a pervasive feature of modern critical reason, and where there is insistence that all knowledge takes the form of hypotheses. Relationships exist solely for whatever rewards the relationship can deliver. Systems of accumulated expertise represent multiple sources of authority, frequently internally inconsistent and divergent in their implications. Instant availability of data and the explosion of knowledge lead to a belief that harnessing the knowledge explosion offers the key to total and instant information and the power to control everything.

A third challenge is to accountability and monitoring NPOs is the challenge of the appearance of impropriety. Although rules and codes of conduct and ethics have been around for a long time, what is new and unique over the past few decades has been the fact that these rules tend to express appearances and procedures rather than matters of substantive morality and ethics. How does accountability thrive in the context where true facts relating to ethical conduct can be manipulated by good public relations experts?

A fourth challenge is the assumption that accountability represents some moral virtue. Contrary to popular understanding within the third sector, accountability is not a moral virtue. Rather, it is simply the language used by certain “experts” to describe and evaluate the process of whether money is treated in accordance with certain specified rules.

A fifth challenge is the challenge of understanding the nature and role of government with regard to civil society and accountability, and threats to freedom and accountability.

The sixth challenge is what might be called the challenge of media ecology. Today, electronic and digital equipment have redefined how we think, communicate with others, and how we have access to the world of information. Where persona are created digitally through MySpace, Facebook, Twitter, blogs, text messages, where we live in a world of virtual reality rather than actual reality, where definitions and concepts of transparency and accountability become confusing, where branding becomes what marketers and public relations make it out to be, and where giving is impulse and manipulated giving prompted by television and Internet images, donor loyalty, and principles of accountability become things of the past. There are real consequences to this, including desensitized passivity, absence even though physically present, inability to make moral judgments and antisocial behavior, isolation and absence, narcissism, instant gratification vs. deferred gratification, and goallessness.

Models for addressing NPO accountability in the face of these challenges include: accountability structures imposed by government; simple disclosure of financial information, such as what is provided by portals like GuideStar, independent rating regimes based primarily on financial data and ratios, and the ICFO model of independent monitoring or self-regulation with independent monitoring.

In most countries, the government model is characterized in its most basic form as requiring registration and providing tax exempt status for NPOs. Little is required other than filing an application and some rather routine decision as to whether the organization satisfies the requirements of law. The danger here is that the government, with its coercive power, can deny status based on its perceived political values and goals. The weakness is that standards without monitoring offer little assurance to the donor public regarding governance, integrity, transparency, and accountability, or that with heavy handed government monitoring with potential denial of status or criminal sanctions tends to increase administrative costs and even prevent the organization from performing its public benefit services.

A model which depends on little more than the disclosure of financial information is largely dependent on self-disclosure, such as in the case of informational tax returns. The weakness with this model is that the disclosures contain rather technical accounting information that often is not particularly accessible to the donor public. Moreover, without diminishing the importance of financial information, this type of reporting says little about the organization, its governing structures and quality, its fundraising operations, potential conflicts of interest, and its compliance with law and other standards.

Models which are based on independent monitoring organizations evaluating financial information and providing rating systems for comparative evaluation of NPOs, have the strength of providing totally independent monitoring schemes. The disadvantage is that this totally independent monitoring scheme is usually funded by some wealthy, self-appointed individual with the goal of cleaning up the sector, but often without any appreciation or understanding of the nature of charity, and dependent upon the work of financial analysts who have some requisite expertise in analyzing financial reports.

The models reflected by the members of ICFO combine an element of self-regulation and independent monitoring through analysis of the NPO against established standards and an accreditation or certification system based on compliance with those standards. The strength of this kind of model is that requires compliance on the part of the NPO with certain standards of conduct that encompass responsible governance of the operations and directions of the NPO, the adequacy of financial information established by external audit processes, the required disclosure of audited financial information, the integrity in the fundraising practices, and the avoidance of conflicts of interest or disclosure of related party transactions.

However, more than simply applying standards of ethical conduct, this model is strengthened by compliance monitoring through evaluation of self-reported information and on-site reviews and investigation, all enforced by appropriate sanctions for noncompliance with the specified standards. Moreover, the strength also lies in part by commitment by those seeking accreditation to a set of standards and to the enforcement procedures that promote integrity, transparency, and accountability within the sector.

Theologically, the interesting point of all of these presentations and of the whole idea of charity monitoring is the vindication of the theological doctrine of original sin. Otherwise, why should anyone be concerned with transparency and accountability in the sector, be interested in what kind of monitoring would be done, whether by government or by some form of self-regulation or independent monitoring through an accreditation process?

It seems that the purpose of all of the discussion in these past two days, and indeed for the concept of transparency and accountability are: to promote moral virtue and competent leadership within the sector and from the sector, to increase and engage public trust, and to engage and promote donor trust. The sector should want to promote loyalty between donor and charitable organizations. After all, keeping donors is less expensive than acquiring donors. Moreover, the sector builds donor trust when it assists charities to gain public confidence in their operations, transparency, and how they solicit funds for the charitable purposes.

Ultimately, the purpose in any regime for promoting transparency and accountability, and model for how this is done, is to promote generosity. After all, this is what should mark both the sector and the donor public, and through it, the character and reputation of a country.

My interest over the past 45 years in the sector is not simply viewing my involvement as a donor, or the contributions of other donors as a financial transaction. I do that when I pay my taxes. Rather, it is my embrace of the needs of the human community and how those needs are met through the organizations I support. My motivations in giving to charity are quite different than my motivations in paying my taxes so that some far-away government authority can address those needs that touch my heart.

Epilogue

As I now reflect on this conference, and the Research Symposium which preceded it, and now write these last lines from my presentation, I thought of a quote from Alexis de Tocqueville I read during my presentation in the Research & Policy Conference, and specifically how different the perspective presented by that extended quote was from a hymn sung in my church recently.

In his *Democracy in America*, Volume IV, Part IV, Chapter 6, *What Kind of Despotism Democratic Nations Have to Fear*, Tocqueville wrote that he had noticed that during his stay in the United States that a democratic social state so similar to America could offer singular opportunities for the establishment of despotism. He noted that on his return to Europe, he saw that most of the rulers of Europe had already made use of the ideas, sentiments, and needs that arose from a social state in order to expand their powers.

As Michael Novak observed during his opening remarks at the opening dinner of the Summer University of Aix en Provence, in August 2005,

We can be pretty confident that Tocqueville would have been quite worried, however, about a new method employed by the state (or if not the state, at least the elites who make it their chief interest to enlarge the state) to turn civic associations into instruments of the State. These new organs are typically called Non-governmental Organizations, NGOs, and many of them are genuine associations, which allow citizens to govern aspects of their own lives cooperatively without turning to the state. But many of them are no more than lobbying organizations, founded and financed to build constituencies for enlarging government activities and government bureaucracies.

And so, quoting from *Democracy in America*, as I did during my presentation, it seems that these thoughts of Alexis de Tocqueville, sum up pretty well what the conference was all about.

When I think about the petty passions of the men of our times, about the softness of their mores, about the extent of their enlightenment, about the purity of their religion, about the mildness of their morality, about their painstaking and steady habits, about the restraint that they nearly all maintain in vice and virtue, I am not afraid that they will find in their leaders tyrants, but rather tutors.

....

I would like to imagine with what new traits despotism could be produced in the world. I see an innumerable multitude of men, alike and equal, who turn about without repose in order to procure for themselves petty and vulgar pleasures with which they fill their souls. Each of them, withdrawn apart, is a virtual stranger, unaware of the fate of the others: his children and his particular friends form for him the entirety of the human race; as for his fellow citizens, he is beside them but he sees them not; he touches them and senses them not; he exists only in himself and for himself alone, and, if he still has a family, one could say at least that he no longer has a fatherland.

Over these is elevated an immense, tutelary power, which takes sole charge of assuring their enjoyment and of watching over their fate. It is absolute, attentive to detail, regular, provident, and gentle. It would resemble the paternal power if, like that power, it had as its object to prepare men for manhood, but it seeks, to the contrary, to keep them irrevocably fixed in childhood; it loves the fact that the citizens enjoy themselves provided that they dream solely of their own enjoyment. It works willingly for their happiness, but it wishes to be the only agent and the sole arbiter of that happiness. It provides for their security, foresees and supplies their needs, guides them in the principal affairs, directs their industry, regulates their testaments, divides their inheritances. Can it not relieve them entirely of the trouble of thinking and of the effort associated with living?

In this fashion, every day, it renders the employment of free will less useful and more rare; it confines the action of the will within a smaller space, and bit by bit it steals from each citizen the use of that which is his own. Equality has prepared men for all of these things: it has disposed them to put up with them and often even to regard them as a benefit.

After having taken each individual in this fashion by turns into its powerful hands, and after having kneaded him in accord with its desires, the sovereign extends its arms about the society as a whole; it covers its surface with a network of petty regulations—complicated, minute, and uniform—through which even the most original minds and the most vigorous souls know not how to make their way past the crowd and emerge into the light of day. It does not break wills; it softens them, bends them, and directs them; rarely does it force one to act, but it constantly opposes itself to one's acting on one's own; it does not destroy; it prevents things from being born; it does not tyrannize, it gets in the way, it curtails, it enervates, it extinguishes, it stupefies, and finally it reduces each nation to nothing more than a herd of timid and industrious animals, of which the government is the shepherd.

See also: <http://rvanbroekhoven.blogspot.com/2010/06/challenges-to-transparency-and.html>

The hymn is: *All Things Are Yours: We Make That True*. The second and third verse read:

"Give out of love" your Word commands;
We are your head, your heart, your hands.
Your Word you underscore with needs
By using us to answer needs.

Oh what a joy to give, and then out of compassion give again. You have no needs -- though that is true. The gifts we share are given to you.

For many, this represents the difference between stewardship and philanthropy.

* This blog post represents my interpretation of the presentations made in Sydney, Australia at the Research & Policy Conference, *Regulation for Not-For-Profit Sector in the 21st Century*, sponsored by the University of New South Wales, Centre for Social Impact. The views are mine and mine alone, and are not intended to convey any positions, intended or not intended, by the University, the Centre, the hosts convening the Research Symposium and Research & Policy Conference, or the presenters. Nevertheless, it was an honor to be invited and to represent the International Committee on Fundraising Organizations (ICFO).