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RECONSTRUCTION AND THE NON-COMMERCIAL SECTOR

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1. EXECUTIVE SUMMARY

The non-commercial sector is a significant part of Australian economic and social life.

If Australian experience of the 2008-09 recession follows that of the UK (which entered recession before Australia), many non-commercial organisations will see unexpected declines in income which will require the identification of appropriate strategies for turnaround.

The legal structures adopted by organisations in the sector are often unfamiliar to Insolvency Practitioners. The issues requiring reconstruction assistance in non-commercial organisations include those encountered in commercial organisations as well others, typically the result of weaker controls and reporting requirements.

The legal environment for reconstruction often differs from the environment for commercial reconstruction; the main differences are identified and considered.

2. INTRODUCTION

This paper surveys issues that arise in the context of reconstruction engagements relating to non-commercial entities.

SCOPE

This paper considers the characteristics of entities that are non-commercial, often referred to as “non profit”, “not-for-profit” or “charitable”.

In saying that these entities are non-commercial, the non-commercial nature of the organization’s activities or its structural form are of greater significance than the commercial nature of some of their operations. Importantly, the paper does not extend to:

- corporate land-ownership (including strata corporations, community title bodies corporate and company title entities);
- emanations of the Crown;
- Micro-organisations, those without employees or significant assets;
- Friendly Societies, Credit Unions or similar organisations supervised by APRA;
- The spiritual activities of religious organisations;
- Lobbying groups and industrial organisations such as trade unions and employer associations.

While interesting issues arise in relation to these organisations, this paper is a more general overview.

ORGANISATION

The paper is organised in four parts:

- The first part surveys the scope of the sector, identifying common issues and key issues in important parts of the sector;
- The second part sets out particular structural issues relating to the legal forms commonly adopted by non commercial organisations;
- The third part deals with the application of the “insolvency skill set” to reconstruction engagements involved in these organizations; and
- The fourth provides a conclusion and links to other useful resources on the issues addressed.

3. PART ONE - THE NON COMMERCIAL SECTOR

WHAT IS THE NON-COMMERCIAL SECTOR?

The non-commercial sector has been the subject of a number of reviews in recent years. One outcome of those reviews is information about the breadth of the sector. As might be expected from what in many respects is the residue after eliminating the "household", "commercial" entities and formal government entities, the sector encompasses a wide variety of organisations, areas of activity, structures and levels of financial sophistication.

An Australian Bureau of Statistics report useful summarises employment levels, organisational numbers, measures of revenue and expenditure, and gives an indication of the structure of expenditures. The ABS groups the sector into the following categories:

- Culture, Recreation and Sport
- Education and Research
- Hospitals
- Health
- Social Services
- Environment, Development, Housing, Employment, Law, Philanthropic and International
- Religion
- Business and Professional Associations, Unions
- Other Activities

CULTURE, RECREATION AND SPORT

This category covers recreational clubs, including the licensed registered clubs of New South Wales and Queensland, as well as a multitude of arts/heritage/ sporting and hobby clubs.

As with the other categories, there is wide range of organizational size, structure, and levels of sophistication. At one end of this category are the professional arts organizations like Opera Australia and the licensed clubs organisations in New South Wales with multiple sites and revenue measured in tens of millions of dollars. At the other extreme are small community organisations, such as embroidery associations and social bridge clubs.

In terms of economic activity, the New South Wales "Registered Clubs" funded by gaming machines profits dominate the category. Information submitted by Clubs Australia, the sector lobby group, to a Senate Economics Committee inquiry indicates that about two-thirds of the income of these clubs comes from gaming machines, the balance from fees charged for services, rentals, meals and the like. The importance of these clubs is shown by Clubs Australia's estimate that they represent 0.5 of a percent of total Gross Domestic Product.

Registered clubs are significant local distributors of the proceeds of gambling into local communities, funding a variety of community infrastructure projects and other benevolent projects such as unemployment relief, job training, and the provision of sporting / recreational facilities such as swimming pools.

In many ways the commercial operations of registered clubs are barely distinguishable from those the "for-profit" sector except that:

- They are unable to access equity funding from capital markets;

- Although permitted to accumulate profits (referred to as "accumulating surpluses"), they are not permitted to make direct distributions of it. However, they are permitted to distribute surpluses in kind by providing free or subsidized provision of services to members; and

- As member-based clubs, there is no formal "owner" able to exert control over the organisation

The range of sporting clubs included under this category is broad. Most sporting clubs, including most professional sporting clubs, are organised on a non-commercial basis. Perhaps more importantly this includes also most sporting organizations, for example the Australian Rugby Union, the Australian Football League, the National Rugby League, Cricket Australia and Football Federation Australia are companies limited by guarantee in this category.

Also included under this category are the various racing codes, most of which have complex arrangements with state gambling revenue authorities for the distribution of some part of the profits derived from the operation of totalisator agencies and levies upon bookmakers. In recent years, these revenue streams have been threatened by the establishment of on-line gambling which enables the realisation of considerable efficiencies in the organisation of events, and the evasion of state and national gaming monopolies which have historically distributed profits to the racing codes. The scale of this threat has receded somewhat with the prohibition of on-line gambling in the United States, but remains something of a threat to Australian racing organizations.

EDUCATION AND RESEARCH

Under this heading fall:

- most independent schools (although some religious schools are organized as divisions of or unincorporated associations under the control of particular religious organizations);

- University Colleges;

- most Universities and similar institutions of higher learning, which are usually specifically incorporated under their own Act of Parliament, although are not strictly "emanations of the Crown",

- learned societies and medical research organisations typically affiliated with public or private hospitals.

Many educational facilities maintain affiliations with other non-commercial organizations; examples being schools and University Colleges run by religious organisations. Where the affiliation extends to involvement in supervisory committees, the respective rights and responsibilities of the organizations can be unclear.

HOSPITALS AND HEALTH

Much of the health sector in Australia is organised as non-commercial organisations, even where the overwhelming source of funding is government funding. Aside from the "public teaching hospitals", there are:

- community-owned medical facilities, such as rural and non-profit hospitals and convalescent homes;

- professional organizations involved in health or ancillary activities (such as the Royal Colleges, the Red Cross, St. John Ambulance, Royal Lifesaving Society, etc.); and

- Condition specific organizations, such as the Cancer Council, Heart Foundation, Multiple-Sclerosis Society, Diabetes Australia and the institutions for the Deaf, Dumb and Blind.

Many of the condition–specific organisations provide a variety of services to both sufferers, their immediate family, as well as undertaking advocacy, some of which has not traditionally been regarded as purely charitable.

Some large, older condition -specific institutions have begun as charitable organizations and have retained at least nominal independence from government, and are still, at least nominally, independent.

SOCIAL SERVICES

This category encompasses activities such as youth and family welfare services, child care, services for the disabled and elderly (including not-for- profit nursing homes), refugee and homeless assistance, emergency accommodation and shelters.

The entities operating in this particular sector are dependent upon rebates from government, but not directly under government control. Often operators are in a position of competition with private suppliers (as is for example the case with nursing homes), and highly regulated (as is again the case with nursing homes). Somewhat in excess of fifty percent of income in this category is derived from Federal, State and Local government.

ENVIRONMENT, DEVELOPMENT, HOUSING, EMPLOYMENT, LAW, PHILANTHROPIC AND INTERNATIONAL

This category includes some of the most high profile not-for-profit entities (for example Care Australia) as well as many smaller organisations including community legal services, interest groups and a variety of employment placement and recruitment services. While the largest source of income from this sector is derived from government (35%) it is also the recipient of considerable donations, sponsorship and fundraising (30%) and income derived from services (15%).

RELIGIOUS ORGANISATIONS

While this paper is not concerned with organizations established for religious or spiritual purposes, under the rubric of religious organizations fall a range of additional service providers, for example schools, social, benevolent and relief organizations. In the case of many of the large, long established religious organizations, the structures adopted are, perhaps surprisingly, informal. They may be designed with a view to avoiding internal organizational disputes being referred to the secular courts – a process which has proved inconvenient and costly in the past.

The sophistication of the internal government structures of religious organisations vary considerably, in accordance with both religious tradition (some religious organisations take the view that there is a universal form of arrangement of administration and hierarchy; others placing considerable emphasis upon local autonomy, and accordingly organising a wide variety of formally incorporated organisations. In practise, internal organisation may overlay and diverge from the essential legal structure adopted, as is the case for example with various Roman Catholic organisations organised under the, legal title of (endowment societies).

BUSINESS AND PROFESSIONAL ASSOCIATIONS AND TRADE UNIONS

Employer, Professional, and Trade Union organizations generally fall outside the scope of this paper. Trade unions and employer organizations are normally incorporated under relevant industrial legislation which often require more detailed and prescriptively determined disclosure of financial performance than is required of other non-commercial organisations.

OTHER ACTIVITIES

This category includes such activities as a range of cooperative / not for profit manufacturers, wholesalers and retailers as well as cemeteries.

Organization structures, as might be expected given the breadth of the industries involved in the non commercial sector, there are several different structures commonly applied. Some of the structures are legal structures, others are organisational structures in the sense of the management structure.

CHARACTERISTICS OF THE SECTOR

The breadth of the sector limits the extent to which generalisation can be made. However, there are some organisational characteristics that tend to be common in the sector, and which distinguish it from both government and commercial organisations.

REPORTING, ACCOUNTS AND MANAGEMENT INFORMATION

While it is the invariable requirement of organisational constitutions that accounts be prepared and financial records be maintained, there is a wide disparity between the accounts maintained, and not generally great comparability.

While many entities in the sector are "reporting entities", and companies limited by guarantee, as public companies, should invariably be treated as such, many do not comply with the terms of standards applied to public company accounting, embodied in the Australian equivalent to International Financial Reporting Standards (AIFRS). Even in the case of companies limited by guarantee, compliance with notionally applicable accounting standards varies.

In part this reflects the experience and sophistication of many micro- and small organisation financial officers. In larger organisations it also often reflects a desire to deliver reports perceived to be more meaningful to members; an unwillingness to incur the substantial costs that can be involved in preparing financial statements at the "reporting entity" level; and a desire to preserve comparability from year to year in the context of stewardship and advocacy roles.

Departure from AIFRS is not necessarily undesirable; indeed their use may tend to confuse many users (especially the application of the Financial Instruments standards). However, in some cases the format of reports may also not enable ready determination of whether an organisation is subject to on-going operational deficits, or incrementally unprofitable operations. This is a general reflection of systems of stewardship accounting, which can obscure financial information connected with provision of services.

Operational information can often be unreliable, uncollected or irrelevant. A stewardship focus in accounting systems will often obscure the costs of particular programs, especially where overhead time is shared between different programs. Organisations with a history or determined commitment to advocating for greater expenditure on particular subject matters and which are driven by a desire to deliver services often have a culture unsympathetic to the critical assessment of the value of services delivered to their recipients, the opportunity cost of delivering services to one client over another and an antipathy toward ordinary management accounting techniques. This can mean that some particular causes receive a disproportionate benefit from the organisation, and that staff are not managed with a goal of achieving overall organisational efficiency.

The often voluntary or, if paid, inexperienced nature of financial staff can result in the retention of accounting policies that are consistent with past standards, or where consistency with historical accounting policy strongly preferred to comparability with modern forms of accounts.

The availability to and use of accounts by often unsophisticated users provides additional reasons for adopting what in other circumstances might be regarded old-fashioned approaches to accounting, including the use of conservative revenue recognition and prudent expense recognition principles

In practice, many accounts are maintained at a cash book/trial balance level; others are prepared on some variant of an accruals basis. Many organisations tend to under report employment related liabilities (such as Long Service Leave) and carry long term assets at either fully depreciated or substantially understated historical carry amounts.

Where organisations do not have professional financial accounting staff, the preparation of accounts may be undertaken substantially in arrears, and be based upon primary financial records. Predominantly voluntary organisations, in particular, can encounter difficulty in maintaining appropriate records, where changes in volunteers may result in a failure to maintain from year to year a permanent record of decisions, for example in relation to loans; and a high level of cash-transactions of comparatively low value, where the cash receipts are not closely related to particular transactions.

The deviations from accounting standards mean that, despite ASIC's guidance in Regulatory Guide 85 non-reporting entities should apply the "measurement and valuation" components of accounting standards, means that the accounts maintained in relation to the organisation's activities are often less reliable and less readily intelligible to an outsider than is the case with a commercial entity.

SECURED BORROWING

Other than companies limited by guarantee, most non-profit entities stand outside the conventional security registration regimes. The schemes applicable vary from state to state, and are not widely known.

For unincorporated associations, it is virtually impossible to grant an effective floating security, they being generally treated as natural persons and subject to the operation of the registration requirements of the *Security Interests in Goods Act 2005* (formerly the *Bills of Sale Act*), whose registration requirements effectively render floating security impossible.

The requirements for securities granted in respect of incorporated associations and cooperatives are specified in the respective Acts: the *Co-operatives Act* incorporates a scheme similar to that contained in the *Corporations Act*; the *Associations Incorporation Act* contemplating registration of associations as "Registered Bodies" under Part 5B.2 of the *Corporations Act*.

DONATIONS, FUNDRAISING AND ASSISTANCE IN KIND

Many charitable and benevolent organisations receive informal support (often not accounted for, and poorly documented) from like-minded organisations or sympathetic benefactors. This can mean that the terms of leases or rights of occupancy that are poorly documented, if at all, with the consequence that the rights and obligations of the organisation cannot be readily determined.

The last decade has seen some growth in the popularity of donor-controlled philanthropic foundations, creating a market for specific-purpose donation-seeking, through which donors can seek accountability and to exercise some control over the use of donations by making periodic rather than lump-sum contributions. Traditional means of direct donation typically involve outright gifts, and little opportunity for on-going management by or reporting to the donor.

Each state has a separate regime for the regulation, and in some cases, registration of organisations raising funds from the general public. These requirements are often ignored, both by the nominal regulator and by non-commercial organisations. Where applied, they generally seek to impose a measure of transparency for the benefit of donors. The particular requirements typically do not reflect accounts prepared on a conventional accounting basis.

WORKFORCE

As has been remarked earlier, the diversity of the organisations under the description "non-commercial" is wide. Likewise, so is the workforce. The sector covers organisations ranging from well managed, highly sophisticated organisations in the medical / health and education sectors through to organisations where labour may be unskilled, unqualified and long term, and subject to little external discipline. Organisations can, when not subject to external challenge, develop cultures of internal focus, empire building, and similar distractions from vision operation.

Much of the labour input to the operations of non-commercial organisations is provided on a voluntary basis. Typically, volunteers, not being subject to the discipline of censure or dismissal or rewarded by direct payment, can prove a difficult workforce. They may treat direct instruction as impertinent or a basis for reducing exertion, and perceive their contribution as itself inherently worthwhile, where from an organisational perspective the contribution may serve little purpose or in fact be counterproductive.

Volunteers often develop a social network within voluntary organisations, so their participation serves both their desire to contribute to the organisation in question and to satisfy their own social needs. Volunteers can also develop a sense of "ownership" of their organisation. When an organisation is performing well this is to be commended. However, where discordant ownership or conflict about organisation goals develops, the sense of ownership can become an impediment to efficient operation of the organisation and to re-organisation.

In many, especially the health-sector non-commercial organisations, there is a strong history of union activity, with occasional tension between paid and unpaid members of the organisation's workforce. Examples have included fire brigades and ambulance / paramedical services. Workforces in the government-funded non-commercial sector can tend to resemble those in public sector institutions rather than those in the private sector, with the tendency towards the convenience of dealing with union representatives, rather than adopting a more active human-resources management model.

INSURANCE

Public liability insurance for voluntary organisations has been a source of public disquiet over the course of the last decade, especially in the immediate aftermath of the failure of HIH Insurance, when insurance premiums rose to levels regarded as untenable.

The relatively poor operational controls of many organisations can create problems of under / non insurance either because of the tendency to seek to “economise” on insurance costs, or failing to comply with confidentiality requirements and/or operational standards. This can lead to “catastrophic” failure of an otherwise sound organisation where it encounters an uninsured liability.

INTERNAL STRUCTURES

Organisational structure normally adopted depends upon the scale and location of the organisation’s operations.

In micro-organisations, management, direction and operations are likely to be conducted by one or more committees of volunteers, selected directly by the members.

In larger organisations relying on a voluntary staff, the role of financial controller, often styled “Treasurer”, is that of steward and in part, “man of affairs”, often a person with some accountancy expertise obtained from occupational experience.

Organisations whose operations are sufficient to warrant employed staff typically segregate the roles of an executive committee from that of day-to-day operational management employing a “general manager”, “secretary”, “administrator”, or in larger cases “Chief Executive Officer”.

This separation of control by the committee, which will often meet at regular intervals but not so frequently as to supervise carefully the day-to-day management of operations, from day-to-day operations, can create control issues where a dominant manager can operate under comparatively light supervision and take control of management of an organisation. Conversely, weaker managers may not be brought to account for non-performance and/or indecision because of the need to obtain Board/Executive Committee decisions on matters that are often contentious as between members of a committee.

In multi-employee organisations there is greater risk of an imbalance between the nominal strategic management of an organisation and the day-to-day managers, with the latter often possessing greater technical and / or managerial and / or financial expertise than the executive committee. Such organisations include the larger registered clubs, agricultural cooperatives and many health and community services organisations.

MANAGEMENT

In organisations with a long history, few external challenges, and comparative financial comfort, it is not uncommon to encounter managers who have "risen through the ranks" acquiring either on-the-job training, or studying externally while employed.

Newer, younger organisations or those that have successfully implemented significant internal change are more likely to have experienced an inflow of experienced managers. While long term management facilitates retention of a very strong knowledge of the history of their operating industry, it can work against the organisation by leading to conservatism about work procedures, the stifling of innovation, and the development of strong relationships with supervisors / regulators and others, so that the environment is adapted to the needs of management rather than management to the needs of the commercial environment. This tendency will be exacerbated where members and/or independent supervisory committee members are relatively passive.

Conversely, in smaller and newer organisations, managers may be committed but inexperienced or lacking in managerial ability and have a poor understanding of the regulatory and economic environment facing the organisation. This can result in poor decisions regarding strategic management, the exposure to liabilities that might have been avoided, and a commitment to unrealistic projects, with consequent financial difficulties.

Without the control and strongly motivating interest of private ownership, organisational management may become detached from day-to-day operations, and lose a focus upon organisational goals and its environment.

DECISION MAKING

There is wide dispersion in the quality and approach adopted for decision making. Some organisations are run on very professional terms, with decision making processes akin to those of large commercial organisations, for examples some of the medical and sporting charities. In others, often at a smaller level, decision-making may involve protracted periods of delay or inactivity punctuated by internal organisational disputation, and infrequent meetings.

Typically, decisions of a particular financial importance, or organisational strategy are entrusted to an executive committee. Executive committees are typically elected on an annual basis by the organisation's membership. In long standing medium-scale entities, and in some very large entities, executive committee membership may become dominated by or "closely aligned with" incumbent management. In smaller organisations, executive committee membership may be held for many years; examples of membership of executive committees exceeding forty years are not uncommon. Decision making in many organisations has a tendency towards conservatism and risk aversion.

Because executive committee members are very often voluntary, there can be a tendency on the part of some to consider membership of a committee as a matter of social status or as an opportunity to obtain collateral benefit. It may suit those with free time, rather than those with managerial skill. In other cases, members elected on a particular platform by a lay membership may not be appropriately skilled or qualified to discharge the duties of an organisation as it either changes to grow; or faces external threats.

While beyond the scope of this paper, I will mention the possibility of corruption in the management of executive committee elections; allegations of such conduct can result in significant adverse publicity for the organisation. An example is the recent inquiry into elections at the South Australian Jockey Club.

CAPITAL MARKET ACCESS

One of the singular distinguishing characteristics of the non-commercial sector is the very limited access that participants have to outside capital.

Typically, access to capital is restricted to either that which is internally generated – the accumulation of past trading surpluses – or that which may be available from commercial lenders. In some instances (and typically after formal procedures are adopted), entities in a particular field may have access to funding from related entities (for example by amalgamation), examples being the quasi-commercial activities of religious, sporting, recreational or other charitable bodies, where however facilities are often provided by way of either grant or loan.

Access to arm's length funding is normally restricted to borrowing, and that often against real property given a tendency toward weak internal controls and the non-commercial nature of the organisations. Restriction on the ability to raise capital practically eliminates the scope for capital-raising as a means of responding to adverse external events. It can also motivate a tendency toward financial conservatism which may in turn be evidenced by the accumulation of sinking funds or reserves held against anticipated contingent liabilities and / or adverse circumstances.

When responding to external threats organisations may be compelled to carry through "sale and lease-back" or asset realisation strategies in order to fund operating deficiencies.

Organisations with a strong relationship with a financially sound affiliate may be able to obtain the indirect benefit of guarantees; similar arrangements can sometimes be procured from state or local governments, although not typically on a recurrent basis.

TAXATION

Most entities in the non-commercial sector are exempt from income taxation, either expressly – because they qualify for exemption from income tax under ITAA 36 – or because their surpluses of revenue are small.

Of perhaps greater significance is the eligibility of some organisations for "deductable gift recipient" status, which is available to charities and certain endorsed organisations, and concessional Fringe Benefits Taxation treatment. FBT concessions can provide an implicit employment subsidy to organisations with a significant staff level, typically those with sophisticated financial advice. Over the past two decades, many of the larger, more professional hospitals and social service providers have been able to "salary package" significant benefits to staff at concessional taxation rates.

The availability of gift deductibility endorsement is a matter of controversy, because it can provide organisations with access to concessional income. In some circumstances, charitable structures may be utilised primarily for the indirect "parking" of income derived by high income earners. It is not the intention of this paper to consider devices of this sort, which will typically present few opportunities for restructuring.

However, it is worth mentioning one matter of controversy, which has been whether organisations have self assessed for gift deductibility under their "charitable" status may engage in advocacy activities. "Charity" is a term which has derived it usage in the Australian taxation law from the Elizabethan *Statute of Charitable Uses*, which prescribed the following as charitable:

- The relief of poverty;
- The advancement of education;
- The advancement of religion; and
- Certain other benevolent purposes.

These requirements have had considerable influence on the law of charitable bequests, forming an exception to the normal requirement that a trust must be established for an object, rather than a purpose.

The inclusion among the heads of charity of the "advancement of religion" has become controversial in the last few decades. From an historical perspective, the converse – that causes beyond the *Statute* were not charitable - has had occasional amusing results: it was the basis on which the bequest by the playwright GB Shaw for the purpose of supplementing the English alphabet with 14 more characters was held not to be charitable.

In more recent times, the advocacy activities of environmental charities such as the Wilderness Society and Greenpeace, as well as social justice organisation such as the Society of St Vincent de Paul, the Wesley Mission and Anglicare have caused some controversy.

In short, where an entity ceases to qualify as a charity, its donors will lose their ability to deduct the amount of their gifts from their income; this is usually expected to have a significant adverse effect on the organisations' income. There appear to be few cases in which such a change in status has occurred, and none of note; however the issue remains one of tension between the advocacy charities and the revenue authorities.

At a state level charities and to some extent other non-commercial organisations are exempted from:

- Payroll Tax
- Stamp Duty; and
- Local Government rates.

These concessions can, in the case of a land or employment – intensive organisations be of considerable value, providing them with an operational advantage over private competitors where the non-commercial organisation is engaged in a commercial, or quasi- commercial activity. Additional examples of concessions of this sort include merger relief which would not necessary be available to private entities.

It is worth noting that charitable receipts received from bequests ordinarily attract benefits of tax deductibility, such concessions being available only to inter vivos gifts.

FEDERALISM ISSUES

Rather more than is the case now with commercial entities, many non-commercial entities retain federal structures where principal operations are carried on in the metropolis of each state, and a national federal body coordinates, to a greater or lesser degree, the activities of each State organisation.

These structures often allow state associations to determine their own priorities, their own marketing activities, employment policies and administrative activities. They can reflect a comparatively high administrative cost and reinforce parochial interests and the absence of pressure based upon cost and / or net revenue maximisation goals which would motivate change in commercial entities.

Conversely, many organisations of more recent establishment commence with strong central/national organisational bodies, and weaker, and sometimes not state-aligned, subdivisions.

In submissions to the Senate Committee report referred to above, the potential for duplication of effort, administrative cost and for the divergence of policy from one central "brand" is commonly remarked on. In the case of charities, the requirements are often dictated in part by the different state fundraising and licensing requirements for lotteries and other fundraising activities.

INDUSTRY-SPECIFIC ISSUES

Set out below are a issues relevant to non-commercial organisation operating in particular sectors.

REGISTERED CLUBS

In New South Wales and Queensland, registered licensed clubs which are prevented from distributing profits derived from their activities, for many years held statutory monopolies on the use of gaming machines (poker machines). While these monopolies have been relaxed, the entrenched position of existing clubs results in them being a significant part of the gaming machine industry.

RACING

As noted above, various codes of horse racing (trotting, thoroughbred racing and jumps racing) are regulated under schemes whereby they receive a proportionate share of totalisator revenue, and exact fees from on-course bookmaking arrangements. Typically the operations of the racing codes are subject to detailed (and often obscure) state government regulation resulting from the connection of racing to gambling; typically however non-commercial organisations are charged with responsibility for administering the regulatory regime.

PROFESSIONAL ORGANISATIONS

While the effect of National Competition Policy has been to remove the formal barriers of entry formerly common in relation to professions and trades, many professional and trade associations retain a position of dominance in respect of irrespective trades, professions and occupations, assuming something of a public interest / consumer protection role, as well as a professional regulatory / qualifications recognition role.

In some areas, in particular the specialist qualifications field, professional associations (in the case of medical specialisations, the Royal Colleges) retain considerable influence over the granting of entitlement to practise, and the training of candidates for particular professions. Other examples of such organisations include: the accounting bodies; those licensing surveyors; town planners; architects; solicitors; barristers; engineers; financial planners and many of the building trades.

LICENSING

Most recreational and many sporting clubs enjoy preferential privileged access to liquor licences, which in markets where it is difficult to obtain either planning permission for, or the outright grant of licences to commercial entities, are valuable assets of the clubs in question.

The terms of licences vary from state to state, but tend to comprise either a principal club licence, permitting the club to purchase and sell by retail alcohol; and limited or restricted club licences, requiring the club to purchase alcohol from other retail licensees, but permitting it to sell it to either its members or its members and the general public, or which are restricted to particular days, or to a limited range of trading days.

Partly for revenue protection reasons, and partly for reasons inherent in the establishment of the licensing regime, there are controls over the qualifications, and employment of staff involved in managing licensed operations, which may restrict the ability of club members / executive committee members to become involved in aspects of the management of the operations of the licensed entity or to remove employees where employees are the sole or principally designated employees discharging particular responsibilities imposed by licence terms.

NURSING HOMES AND RETIREMENT VILLAGES

Nursing homes, private hospitals and similar institutions are subject to complex Federal and State regulations, partly imposes a condition of receipt of Commonwealth Government funding. Key among these are the award of “beds” to particular institutions, to which are tied funding. In the field of Retirement Villages, there are various consumer protection schemes.

SPORTING FACILITIES

Many clubs receive subsidised / supported access to community sporting facilities on the basis that they continue to operate within often unspecified expectations as to the provision of community services.

For example, a local sporting club may obtain access on concessional terms to Council-provided sporting grounds in the expectation that the sporting club will conduct itself on a "not-for-profit" basis and provide opportunities for local sports players to participate and develop skills in particular sporting codes.

The terms on which such arrangements are provided often impose an obligation on the part of the sporting club to contribute to the establishment and / or upkeep of grounds on terms however that fall short of requiring the club to meet the full commercial cost of provision of facilities.

Such concessional arrangements can become controversial if the club is perceived to be representative of a minority and / or declining sporting activity. An example is the decline in the number of lawn bowls clubs, where many clubs have amalgamated to accommodate fewer active bowlers or diversified into other sports making use of similar facilities (for example, lawn tennis and, occasionally, croquet). As the nature of club activities changes, the willingness of local government authorities to continue concessional arrangements may change. At the extreme case are formerly sporting clubs which have become principally entertainment venues at the instigation of professional managers of an entrepreneurial kind. These have resulted in considerable local pressure for the termination of the concessional arrangements.

ORGANISATIONAL WEAKNESSES

Under this heading I will briefly consider a number of sources of “organisational failure”.

THE BIG MAN

In an organisation with a weak or sympathetic supervisory group, the operations of the organisation may become dominated by one particularly enthusiastic, capable or dominant manager. In circumstances unconstrained by external accountability requirements through profit – making, a person in this role can:

- obtain an above market remuneration package or the benefit of the “quiet life”, performing at a standard less than might be expected of somebody at their level of confidence / remuneration;
- exercise undue influence over the body of the organisation such that any threat of departure or departure by accident / death of the incumbent results in a major interruption of the organisation’s activities;
- create opportunities for indirect financial benefits to accrue to the through development of long term, mutually rewarding, relationships between the manager and suppliers;
- can lead to insufficient financial accountability, even from a stewardship perspective, where management committees defer to the manager and / or decline to press for operational and financial information; and
- create opportunities for nepotism.

THE BIG PROJECT

Organisations facing external challenges can succumb to the “Big Project”, a mechanism by which the organisation’s resources are either diversified away from existing activities, or are concentrated on a new venture. Common examples include the capitalisation on under-used property resources by land sub-division or building re-development.

Big Projects can release value from accumulated and underused assets, but they can easily take existing management outside its area of competence and result in the accumulation of trading losses and / or commitment of organisational resources to “one basket” which may be poorly managed or become a distraction of the delivery of the organisation’s core activities.

Paradox idly, the marketing activity surrounding a “big project” may accompany a rise in the enthusiasm for the organisation both on the part of organisation members, donors and the supervisory management.

Organisations that are able to adapt management processes and habits away from those which have adequately served for day - to - day operations to strategic decision making are more likely able to succeed in achieving such projects. Conversely, those which fail to respond effectively and flexibly to the challenges of strategic decision making, and which are unable to identify the need for and suitable means of achieving appropriate enterprise resourcing, are likely to fail. Often, the concept behind a "big project" may have a long gestation, over which time, an organisation can become committed to such a project even where its time may have passed.

THE OVER-OPTIMISTIC COMMITTEE

Many organisations with a high level of executive committee turnover can encounter problems with organisational leadership burn out as over – ambitious, unrealistic goals are set for performance; and committees procrastinate over decision making. This can become a self-perpetuating cycle of over-enthusiasm, followed by a failure to perform and then the loss of disappointed members, leading in turn to a further intake of "new blood", who begin the cycle again. A committee that tempers fresh enthusiasm with experience is likely to result in a better balanced and more realistic assessment of an organisation's abilities.

MICRO MANAGERS

Where committees are of inexperienced, the time of the committee can be occupied in the resolution of disputes, and micro-management of administrative / management details, especially where management meetings take the form of instructions to operational staff.

MAJOR DOMO DONORS

Charitable organisations may become dependent a small number of large donors. While appropriate responsiveness to large donors can be an important means of successful development of a charity, the pursuit of such donors to the exclusion of a broader revenue-base can make a charity vulnerable to the vicissitudes of the donors.

If a charity establishes operations in the expectation of continued donation income, it is likely to incur both direct trade indebtedness to suppliers and contingent liabilities to employees. Any interruption to donation income resulting from disappointment of a donor or disaffection with the organisation's performance can precipitate a rapid financial crisis on the part of the charity.

THE EMPIRE

The comparatively weak nature of financial reporting and strategic oversight in many non – commercial organisations and the absence of a controlling owner can enable the accumulation of a fund which may be used for purposes of seeking to expand the organisation's scale, without necessarily achieving organisational goals.

Management are often motivated to increase sales, expenditure or the scale of operations beyond that which may be optimum because its remuneration and community esteem is likely to be reflective of organisational scale rather than objective measures of performance. Examples of "empire building" can include:

- the acquisition of suppliers or customers (a form of vertical integration), where this is not necessarily to the advantage of the organisation (an instance being the acquisition of a butcher shop by a NSW registered club); or the acquisition of petrol retail businesses by traditional rural supply cooperative businesses, with a history in the supply of agriculture implement / fertilizer and seed. Extreme case of such behaviour is one interpretation of the events leading to the collapse of the National Safety Council of Australia, where a very strong chief executive officer transformed a comparatively modest non – for profit organisation into a much larger organisation, on the basis of fraudulently deceptive accounts which enable the accumulation of substantial liabilities, the diversion of benefits to the chief executive officer and his relatives; and led to the ultimate collapse of the group in 1990;

- "mission creep" as management seeks to provide additional "services", sometimes of marginal value or viability and sometimes an ex post justification for expenditure;

- "gold plating", where unnecessarily expensive operating procedures are adopted, or capital investments are outlayed. The acquisition as a form of "trophy" of an office or building is not uncommon, where alternative arrangements might be made to lease necessary space on commercial terms;

- Pointless investigation: strategic management committees can absorb organisational resources in review and development of operational changes at expense, especially where external consultants are retained;

- Service duplication – the organisation may seek to emulate the provision of services by other providers; where cost-minimization is not seen as an objective any under-utilisation of services can pass unremarked on; and

- Poorly focussed marketing. Brand awareness marketing may be undertaken with little reward. Examples include endorsement of sporting and similar community events where management may receive an additional "kick-back" in the form of sponsor's access.

4. PART TWO - LEGAL ISSUES

ORGANISATIONAL TYPES

The principal organisational types are:

- Incorporation under the Associations Incorporation Act
- Cooperatives incorporated under the Cooperatives Act
- Companies limited by Guarantee
- Unincorporated Associations
- Charitable Trusts
- Other structures such as specific incorporation by Act of Parliament or by royal charter.

Each incorporated form involves some form of membership, some form of separate management committee; and the capacity to sue and to be sued.

Unincorporated associations typically take the form of "clubs", with a membership committee, although as the least formal structure, they can also involve members in direct management. The law has treated membership committees as responsible for the assets and liabilities of the unincorporated association personally, typically treating the assets as held on a form of trust.

Companies limited by guarantee were once a very common form of incorporation. However they have become somewhat less common since the introduction of cheaper and somewhat easier means of incorporating under the Associations Incorporations legislation. However, they remain important in that:

- Many of the largest charities take the form of companies limited by guarantee; and
- Many of the older charities take this form.

It has been suggested in some of the reports, that some organizations prefer incorporation as a company limited by guarantee on the basis that it indicates a scale and seriousness not necessarily expected of an incorporated association.

Non-commercial companies limited by guarantee are governed by the provisions of the Corporations Act in much the same fashion as commercial companies of that form, and many of the provisions relevant to companies limited by shares apply also to companies limited by guarantee. Importantly, this means that the ordinary forms of security and provisions for corporate re-organisation contained in chapter 5 of the Corporations Act apply to them. Companies whose activities are solely charitable or non-pecuniary are relieved from the use of the term "Limited"; this obscures the prevalence of this form of organisation.

The significance of the "guarantee" referred to in the structure is that the promoters and/or leading members of the company grant guarantees when joining the company to pay in an amount in the event that the company is wound up. These guarantees are, like shares, typically for nominal amounts; they differ from shares in not conferring a proprietary interest in the company. Strictly, this is a position very similar to the old-fashioned form of company without limitation of liability, the only difference being that the liability is limited to the extent of the guarantee.

The other forms of incorporated entity are subject to their own separate legislation dealing with their incorporation, with which many practitioners are unfamiliar. I consider the effect of these schemes below.

While a trust may be a bare trust, more commonly it is a form with a management committee which either owns, or controls the actions of a body of personal trustees or a corporate trustee which carries on the particular charitable purpose.

LEGAL STRUCTURES

Summarised below are the legal structures.

THE UNINCORPORATED ASSOCIATION

The unincorporated association is the most straightforward, but equally very often the most risky form of organisation. Frequently encountered examples include university student clubs; sporting clubs and community organisations.

An unincorporated association normally comprise a group of members, and a body known variously as a committee, an executive committee, a board or a steering group. This structure is popular among micro-organisations, but, for reasons set out below, considerably less so among medium or larger organisations. Its chief advantage is the simplicity of its establishment.

The committee-members will normally be regarded as jointly and severally personally liable for the organisation's liabilities, and will hold the assets of it on a form of trust. If the organisation faces financial difficulty, that financial difficulty will be brought home immediately and directly to the members of the executive committee. Deadlock in the executive committee will be resolved by reference to the rules governing the unincorporated association, where they exist and are agreed on, provided they deal with such issues. Alternatively, dispute resolution may require recourse to be had to the Courts. Any recourse to the Courts from micro-organisation will be expensive, time consuming and may well bring about the failure of the organisation.

Unincorporated associations will experience difficulty incurring credit or carrying on any commercial activity.

INCORPORATED ASSOCIATIONS

Associations incorporated under the *Associations Incorporations Act 1984,* soon to be replaced by the *Associations Incorporations Act 2009*. Because of the imminent introduction of the 2009 Act, I have based my remarks on its operative provisions.

The Act provides for two tiers of incorporated Association. Tier one, those with a gross revenue of $200,000 or more are generally larger, and tier two organisations those which are (generally) smaller in scale. The regulatory requirements imposed on Tier One associations are considerably more onerous than those imposed on Tier Two organisations, and will include a requirement to deliver audited financial statements prepared in accordance with Australian Accounting Standards.

Associations incorporated under the Act are required to be conducted for "non-pecuniary" purposes, which prevent direct provision of benefits to them (although these may be supplied indirectly through the supply in kind or services). Again, a structure of membership and executive committee is common. The Act provides for limited liability on part of the executive committee, a chief advantage over unincorporated status. The formalities of incorporation are comparatively straightforward, although the Act provides for a minimum number of clauses dealing with the governance of the organisation, for a minimum number of Australian resident members, and for the appointment of a "Public Officer" who fills a role equivalent to that of a company secretary.

Tier one organisations are expected to provide detailed financial accounts of the sort expected of a reporting entity. In practice, it is doubtful that many organisations will adhere strictly to the requirements of the accounting standards, which will, ostensibly, require the preparation of accounts akin to those of a public company, although little objection appears likely to be taken.

Committee-members of associations may be held liable for insolvent trading, but on a more generous (to them) the basis than applied to the directors of companies. Whereas a company director accrues liability on forming a "suspicion" of insolvency, a committee-member in an association must first have formed a "belief" as to the organisation's insolvency: section 68 of the Act. In practice, this distinction is unlikely to be of great importance.

REGISTERED CLUB

Registered Clubs are either companies incorporated under either the Corporations Act or co-operatives incorporated under the Co-operatives Act 1992.

The Registered Clubs Act 1976 imposes additional requirements on such clubs, and permits some forms of amalgamation not contemplated by the Corporations Act or Co-operatives Act. These include:

- Requirements for a single "Secretary", with "managers" in most cases if the club operates from more than one location;
- Full members join by election;
- Employed full members may not vote at general meetings;

- Members pay annual subscriptions;
- Profits cannot be distributed directly to members;
- They must only operate from their own premises, which is to say they cannot set up temporary operations;
- Have a cap on membership numbers;
- Clubs may amalgamate up to ten times, but not more, by resolution of the members of both amalgamating clubs;
- In winding up (or receivership), approval of the appointee must be given by either the Supreme Court or the Director of Liquor and Gaming;
- They may only dispose of their property in accordance with the procedure set out in the Act; and
- Are subject to intervention by the Director of Liquor and Gaming, who may set aside contracts entered into by the Club.

COOPERATIVES

Cooperatives can either be trading (for profit) or non-trading (non-profit). A non-trading co-operative is essentially a non-commercial venture; a trading cooperative may appear very similar to a diversely held private company, or even a public company.

Cooperatives can compel their members to make compulsory loans to them, although the circumstances in which this can occur are not clear. Cooperatives can issue shares, "cooperative contribution units", a form of non-voting capital are keen to preference shares. Again, liability of the executive committee is limited.

Co-operatives require more than one member. Cooperative arrangements were once common especially in the field of agricultural and horticultural processing, with both supply – purchasing cooperatives and marketing / sale cooperatives. It appears that the principal cooperatives are now based on certain agricultural processing, irrigation, and fishery activities. Another notable cooperative is the University Cooperative Bookshop.

It is unclear what regime currently governs the possible liability of directors of cooperatives for insolvent trading. The Act contains a passage dealing with liability corresponding that formerly opposed by Section 592 of The Corporations Act (which was superseded in 1993 by the current insolvent trading regime in the case of companies organised under the corporations act.

COMPANIES LIMITED BY GUARANTEE

Companies limited by guarantee are incorporated under the Corporations Act. These companies again can be for-profit or non-profit direct.

A company limited by guarantee is a form of public company, with directors elected by members. Unlike a public company, it is unable to issue shares to the public although it may convert itself to a public company limited by shares. If the company adheres to terms essentially preventing it from making a distribution of profit, the company is relieved from the obligation to use the term "Limited" in its public documents: many entities, including the National Rugby League, Cricket Australia, the Australian Football league, Football Federation Australia, and Opera Australia are companies limited by guarantee.

Although there is little inherent in the structure that is attractive, larger scale organisations in the non-commercial sector prefer this company structure. The incidents of incorporation in this case are well known, they follow those of the public company, with the exception that in the event of the company being wound up, the liquidator may be entitled to call up guarantees which are akin to uncalled share capital. The law applicable to insolvent trading by directors of commercial entities applies to directors of companies limited by guarantees.

TRUSTS

In addition to the corporate structures outlined above, it is possible for charitable non-commercial organisations to be structured as a trust, in particular into the form of a charitable trust. This paper is not the place in which to deal with the frequently obscure issues arising from the law of trust. The key principles are:

- A charitable trust can be perpetual; traditionally non-charitable trusts were subject to laws against perpetuities and accumulations;
- A charitable trust must for "charitable purpose";
- A charity will either be governed by the Trustee personally or by a management committee to self govern the Trustee;
- These trustee may be either a separate corporate body, or a group of natural persons associated by joint ownership of the assets, or some combination of natural persons and corporations;
- The trustee(s) is personally liable for the liabilities incurred by the Trust; subject to the compliance with the terms of the Trust, the Trustee will have a right of exoneration and indemnity out of funds held on trust; and
- In the event of financial failure, the position of the Trust will be dictated in large measure by the nature of the trustee.

FORM OF EXTERNAL ADMINISTRATION

The ways in which non-commercial organisations can be externally administered, while obscure in origin, are in many respects familiar.

COMPANIES LIMITED BY GUARANTEE

The most familiar form of external administration is that applicable to companies limited by guarantee. These are subject to the full range of external administration available under the Corporations Act including receivership, liquidation, voluntary administration and scheme and arrangements, although the restrictions applicable to appointees to companies that are also registered clubs has been noted above . Given the familiarity of this area, I will not consider it further.

It is not clear whether an externally administered can undergo transformation into another form, so that a company limited by guarantee can convert into a company limited by shares (such a scheme might facilitate debt-for-equity conversion).

INCORPORATED ASSOCIATIONS

Under the Associations Incorporation Act, the provisions of the Corporations Act dealing with Voluntary Administration and Liquidation are incorporated with certain amendments particular to the of association. In addition, a state government official, the Registrar of Fair Trading, may himself make an appointment of an administrator to manage an organisation as if he were the board of directors or management committee. Such a decision is, presumably, reviewable in administrative law.

CO-OPERATIVES

In relation to the administration of Cooperatives, a separate but similar regime for external administration is incorporated into Part 12 of the Cooperatives Act; the officer corresponding to the Registrar being the Director General of Fair Trading.

REGISTERED CLUBS

In the case of Registered Clubs, the mechanisms for external administration follow from the form of incorporation; as noted above, there is an additional requirement of either Supreme Court or government-endorsement.

UNINCORPORATED ASSOCIATIONS

In the case of unincorporated associations, there is, in essence, no “entity” to administer. The financial reorganisation of the entity will require coordination of the members of the executive committee and may involve them seeking joint bankruptcy appointments. The differences in provability of debts may mean that if the financial failure results from a shortfall of insurance against a personal injury claim, external administration must be delayed until judgment is obtained.

In practice, it is unlikely that formal external administration will permit the continuation of an unincorporated association. It would ordinarily be expected that personal liability of the executive members will be sufficiently salutary so as to avoid the incurrence of considerable liability of this form.

TRUSTS

In the case of trusts, the situation is complicated by the potentially different range of trustees. In the case of a corporate trustee, it would appear that the same provisions as to the winding up of charitable trusts are applied in the case of trading trusts, with which the Courts have had to wrestle over the past 30 years. In the case of personal trustees, it appears that the liability of the Trustee is strictly personal, and that accordingly, are likely to be under the same discipline as the executive committee members of an unincorporated association.

5. PART THREE - PRACTICAL RECONSTRUCTION OF NON-COMMERCIAL ENTITIES

INTRODUCTION

As with any reconstruction engagement the "solution" will require careful consideration of all of the circumstances regarding the entity's environment, both internal and external.

The same skills used in reconstruction commercial enterprises are likely to be brought to bear the reconstruction of non-commercial enterprises.

Nonetheless, I make the following observations to the issues of particular relevance to non-commercial organisations.

INDEPENDENCE

While independence is important in all external administration engagements, both the actual and apparent independence of the appointee can be useful in the context of non-commercial entities in a way it rarely is in for-profit entities.

The expertise and objectivity of the external administrator, whether formally appointed or informally retained, can ensure that accurate, timely and impartial information is provided to interested parties. There is often an unfilled gap between the information available to interested parties and what they may realistically expect. The appointee who is able to bridge this gap will be able to facilitate transparency and accountability where it may have been absent.

WORKFORCE

Most, if not all non-commercial organisations will have a workforce either partly or substantially comprised of "volunteer" or "semi volunteer" staff employed in the organisation as a reflection of their commitment to the particular actively organisation undertaken as opposed to commercial gains.

Management of such staff, who may not be necessarily be familiar with frequent performance appraisal and strict supervision, can present challenges over and above those likely to be present in the case of a commercial enterprise. The greater the discount or disparity between the market wage and that received by the employee /volunteer, the greater is likely to be sense of possible resentment at the need to restructure, or change behaviour.

DONORS

Where an organisation has depended upon donors and or requests, any rapid change in the organisation's commitments may lead to a reduction in contribution and / or withdrawal of proposed bequests. Conversely, an organisation with a poor history of accountability and communications to donors may be able to improve its ability to attract bequests.

Any loss brought about by the involvement of an external administrator must be measured against the potential loss of contributions likely to eventuate from events surrounding possible failure of an organisation. It is rare to find a donor / testator with particular regard for the creditors of a defunct organisation. Engagement with key donors and the identification of a strategy ensures the maximisation of return for contribution is likely to form a major part of an effective restricting program.

ORGANISATIONAL KNOW-HOW

More than usually found with public companies, although comparable to that of some private companies, organisational know how, including the terms of supply arrangements, internal operational systems and the recollection and history of dealings with outsiders, and the means by which problems have been successfully overcome internally are likely to be embodied in staff.

This is a challenge, as most restructuring programs are likely to require some reduction in staff numbers, or involve the redeployment of staff to roles not of the staff's choice, and where the staff most likely to require redeployment and / or retrenchment are those most likely not engaged "face–to–face" service delivery.

PUBLIC PERCEPTIONS

As mentioned earlier, donor perceptions are important. In many respects a non-commercial organisation's ability to manage itself, or communicate a lasting impression to potential donors and gain the sympathy of the community at large to the charitable cause may comprise the principal commercial asset of the organisation.

Scandalous behaviour by those involved in the organisation, for example self –indulgence by senior managers or the frequent "misbehaviour" of sporting players in the case of sporting leagues are likely to affect adversely on community sentiment and present a threat to the organisation's long term prosperity and in the short term its ability to facilitate and obtain taxation and facility concessions from local / state and federal government organisations.

FUND RAISING

Some organisations will be in a position to tap into a stream of donors when pressed for financial survival; many will be unable to do so.

In the absence of the ability to raise funds directly from gifts, or to issue share capital, on the basis they are not profit directed concerns, alternative means of obtaining capital may be required. It is difficult to generalise but examples can include:

- concessional loans granted by local or state government;
- provision of guarantee support by state funding bodies;

- the provision of concessional funding by related entities (for example where there is a relatively more prosperous national, or interstate affiliate, or where the organisation is part of an illegitimate organisation with numerous affiliates);

- In the case of cooperatives and companies limited by guarantee, another option is conversion to a commercial enterprise structure which may however be prohibited by the penalties payable upon the entity ceasing to qualify for concessional taxation;

- The provision of loan finances especially where surplus assets may be available for realisation in the medium term but are not immediately available; and

- Funding by means of a moratorium, either informally agreed, or resulting from external administration imposed on the company's creditors.

MANAGEMENT RESTRUCTURING

Organisations experience financial difficulty will often have experienced a considerable turnover of management expertise, especially if management have become disenchanted with contributions which may not be rewarded or where the problems faced by the organisation have been foreseen but the observations of managers has not been taken into account.

Conversely remaining management is likely to be those who have been the authors of internal problems. Where, as has been mention above, there has been an imbalance in the power as between professional managers and the supervisory committee, or where incumbent management has obtained control of the supervisory committee, it maybe be necessary for an external administrator to work over sometime with a new supervisory committee, or with a committee un-associated with the former management, to achieve organisational change, possibly including a change in the form of employed management structure.

TURNAROUND

STRATEGY

As within any reconstruction engagement, the process can be boiled down to the following steps:-

- Understanding the operation of the entity;

- Identifying the cause of the financial distress;

- Assessing whether a viable operational model can be taken from the organisation's existing operation and assets;

- If so, determining what is required to move from the current model to the new model; and

- Developing a new strategy for the implementation for these steps required for business transformation.

This paper is not the place to survey turnaround reconstruction models.

In obtaining the necessary understanding of the business point, the usual processes, including Porter's Five Forces / SWOT Analysis / PESTLE analysis may all be of use, while other ad hoc or abbreviated "asset – test" approaches may be appropriate, especially in circumstances of financial emergency.

I have set out below factors which are likely to be of particular prominence in the case of reconstruction of not for profit entities, adopting the above five bullet points as the organising principles. Needless to say, these steps are unlikely to be followed in a lock-step fashion, especially in a financial emergency. They are likely to occur in a different order and the final strategic development will necessary follow very shortly after appraisal of the business. However, the structure lends itself to useful organisation of the issues.

UNDERSTANDING THE OPERATION

Given the broad range of operations referred to collectively as non-commercial, there are some idiosyncratic issues particular to some organisations that will not be relevant to others.

In general, management information is likely to be less reliable and less useful, especially in organisations where there is a tendency not to account for financial consequences of particular operations. Generally there will not be the form of regular "operational" management accounts common among for-profit enterprises.

An immediate issue is to understand the nature of the form of organization. General information is available by searching ASIC's registration records or the Office of Fair Trading's registration records. An OFT search must be made through the Office, and cannot be completed on-line.

In rare circumstances an incorporated entity may be registered under its own Act of Parliament or under legislation such as the *Life Insurance Act* (for example, friendly societies).

Where the organisation has carried on commercial or quasi - commercial activities there may be scope to increase revenue by increasing service price. Scope for such increases will depend on the level of service competition; the willingness of customers to accept price increases; a willingness on the part of customers to accept "buy in" to the re-organisation of the entity's operations; and the extent to which the entity is operating in a competitive market, where customers may be able to retain services on comfortable terms from alternative (sometimes "for profit") supplies.

Where price increases are possible, the process of effecting price changes raises the usual issues of customer resentment, disaffection, and the importance of communicating the basis for price increase.

Price increases reflecting an accumulation of increased labour costs (as often will be the case with labour – intensive service providers buying labour in commercial markets) are likely to be more acceptable forms of price increase. Where price increases appear to be a mean of salvaging a poor financial situation for the benefit of creditors, there is likely to be greater resistance and even possibly active resistance on the part of customers.

An additional factor to be considered in this context is the extent to which the organisation's revenue stream is dependent upon political factors such as the support of local government, the availability of state or federal government matching funds / subsidies for supplies. Where government matching / subsidy funds are a principal source of revenue, there may be little or no scope to increase revenue streams in the short term period pending review of long – term contracts. Similar principles may arise where the organisation is a long-term contractor for another organisation or government operator (for example – supplies of employment support services).

Review must also include assessment of:

- Contract and asset forfeiture terms;
- Clarity of the terms on which principal assets are used, especially where these may rest on "gentlemens' agreements";
- The extent of prospective pledges, and the extent to which these may be revoked;
- The extent of inter-entity liabilities, where these exist or may be triggered by reconstruction;
- The abilities and commitment of existing staff and management; and
- The extent of acceptance that the organisation is in difficulty. Where "buy in" is not available, it will be difficult to implement any radical organisational change.

IDENTIFYING THE CAUSE OF FAILURE

Some causes of failure, in particular the realization of catastrophic liabilities such as an uninsured personal injury claim or the recognition of maintenance issues in historic buildings may be clear, although nonetheless difficult for the organisation to resolve.

In other cases failure may be the result of the cumulative effect of several causes, typically including a cost squeeze between declining in financial contributions and rising workforce costs. The usual sources of information and methods of investigation are likely to be required. Given the voluntary and somewhat less professional nature of many non-commercial entities, it is likely that records will:

- Be less readily available;
- Require greater patience and persistence to obtain; and
- Are more likely to use redundant information technology systems.

Conversely, the scale and sophistication of operations is likely to be lower than would be encountered with most comparable commercial organisations, facilitating a better understanding of the operational dynamics.

ASSESSING VIABILITY

The revenue sources of non-commercial entities often being more variable than their commercial counterparts, some greater care will be required in projecting the revenue base of a reconstructed entity. Conversely, pledged commitment or accelerated donations may facilitate turnaround in a way that would not be possible for commercial organisations.

Planning for cost reduction is likely to be made more difficult by less thorough job-description, although in an organisation with historically poor operational controls, may paradoxically be easier than where cost control has been more stringent.

PLAN IMPLEMENTATION

Whatever plan is identified, the diversity of interest groups is likely to make development and implementation of the transformation plan more complex than in a comparable-sized commercial organisation. The implementation plan is likely to require:

- The development, immediately following appointment, of effective and timely means of communicating with interested parties;
- Acceptance from major donors and other interested parties such as government agencies;
- Articulation of a realistic, sustainable and robust operational model;
- Early and clear indication of any requirements to reduce staff, and the sensitive but effective management of the issues arising from any termination; and
- The establishment of robust, timely and cost-effective systems for monitoring both operational and financial performance.

MANAGING TURNAROUND

In addition to the usual issues, the following are likely to be of considerable importance.

FINANCIER RELATIONS

Most non-commercial entities are likely to have comparatively unsophisticated dealings with their financiers, and to have used a range of comparatively unsophisticated financial structures. Such an approach reflects caution on part of the lenders faced with management which may have uncertain commitment and / or financial acumen as well as some restrictions on the legal form that security can take and the generally lower level of financial managerial skill exhibited in the sector. Consequently, the reconstruction engagement can have as one of its principle achievements the establishment of improved communication between financier and debtor.

The reconstruction advisor is also likely, with the benefit of stronger financial skills, to be able to identify financing options that may have been over looked by incumbent management including:

- joint venture operations / transfer of risk to commercial organisations; and
- the use of less orthodox finance techniques such as debtor / revenue stream factoring (something ordinarily restricted to for-profit enterprises but which may provide an opportunity for a financially distressed non-commercial organisation to obtain "emergency' cash flows on a short – term basis).

Management of communication between the debtor and the financiers can also be important in avoiding enforcement action by the lender where enforcement is likely to bring about the termination of operations of the borrowing entity.

EMPLOYMENT ISSUES

It is noted elsewhere, the employment issues likely to be encountered in not-for-profit entities is similar that may be encountered in the for-profit sector. These may include:

- Disaffected employees;
- Low levels of performance management;
- Resistance to organisational change and refocusing; and
- non-acceptance of circumstances financial distress where some members of the labour forces (voluntary or paid) may regard financial distress as being a problem result of other decision maker's views and not accept "buy in" to the problem.

Again, while this paper is not an opportunity to address every issue that may arise in the context of employment in reconstruction, the following issues are likely to be prominent in such organisations:

- Long-term employment relations at below market rates, reflecting in part lower expected performance levels;
- Low levels of performance management and unwillingness / antipathy towards accountability; and
- A focus on democratic and consensual management styles which will often conflict with the directive management needs dictated by financial distress.

SUPPLIER MANAGEMENT

A matter of particular concern in relation to supplier management is the maintenance and reinforcement of concessional supply arrangements, where continue operation of the organisation may trigger price increases in charges or shorting of trade terms from organisations (such as other charities and suppliers who have used "sponsorship" of the non-commercial organisation as a means of marketing or demonstrating "corporate social responsibility") with adverse consequences for the financial performance of the organisation.

In these cases, a clear identification of, and explanation of the reasons for the financial distress and articulation of a strategy for continued organisational existence is likely to be required, even where such information is based upon limited opportunity for investigation / consideration of restructuring strategies.

REVENUE AUTHORITY

The process of adjusting its asset-base or transmitting profit-making activities into commercial organisations raise the prospect of loss of concessional taxation treatment.

In the process of realising assets, it may be possible to obtain a final revenue concession, in particular in the form of concessional payroll tax, land tax and stamp duty depending on the nature of reconstruction undertaken.

INDUSTRY REGULATORS

Regulation of the gambling and liquor- sale activities of many non – commercial organisations mirrors that applicable to for-profit entities, where those involved in management are required to hold particular qualifications / endorsements; and satisfy requirements as to being a "fit and proper" person to undertake the business.

These requirements overlay the ordinary qualifications for governance within the organisation based upon industry / qualifications and expertise. A particular case is the requirement under the Registered Clubs Act 1976 for each registered club to have a secretary / manager responsible for the club's operations and requirement for either Supreme Court endorsement or the approval the Director of the Office of Liquor and Gambling Regulation, for the appointment of any external administrator to an entity subject to the Registered Clubs Act.

DONOR RELATIONS

The market for donations is exceedingly competitive. There are a few constraints on entry of new actors in the "charitable" sector, adding to the many "good causes" to which donors are frequently invited to contribute.

Donations can be one of the weakest revenue sources for an entity largely dependent on them, and where donor perceptions of mismanagement or inefficiency develop, they may lead to sudden and deep falls in revenue. Susceptibility of donation income to decline is likely to depend upon:

- The depth of the relation between the donors and the organisation;
- The extent and medium by which donors have been informed of organisational difficulties;
- The extent to which donors have "bought in" to programs of organisational change, and the associated risk;
- Availability of ready alternative means of satisfying the donors desire for actualisation; and
- The extent to which donors have explained to them:
    - The origins of the financial circumstances; and
    - Strategy for management problems.

Donors are likely to require firm, transparent, verifiable commitment to their contributions being applied to the objects of the organisation donation rather than the discharge of accumulated liabilities. This represents a difficulty for the reconstruction professional where the donor's wishes will often conflict with the organisational needs.

Where it is possible to segregate the donor's contributions from "commercial" activities, there may be scope to stream revenue into the desired activity; allowing other revenue streams to be absorbed and utilised for the reduction of arrears. Conversely, where donors have strong commitment to the organisational objectives with an appreciation and acceptance of the cause of organisational decline, a once-off fundraising campaign may be possible / precipitated by the threat of crisis to the organisational role.

Practical examples of one-off fundraising activities of this sort are numerous and high-profile. For example, many non commercial organisations that own older building assets are able to undertake specific – purpose "building maintenance" fundraising activities to stabilise, restore and or renovate buildings with strong association with the particular organisation, where buildings have often deteriorated due to inadequate building maintenance being undertaken by the organisation.

Another means of providing assurance to donors is the establishment of an independent or partly independent organisation for the separation donor income from that of the organisation itself. The most obvious example of this form of structure is use of "Friends" organisations often used to support long standing educational and artistic organisations. These organisations can operate as a conduit for information to pass from the organisation to donors while providing donors with a level of assurance that donations are being actively managed; that funds are not absorbed in administrative expenses, and often providing a form of social outlet that binds donors to the non-profit entity in question.

A similar structure may be adopted by other organisations where there is a desire to accumulate a capital fund for the perpetuation of the particular organisations. The use of independent fund can provide assurance to donors with a long term requests wish that the organisation receives, and treats requests / capital contributions as such, and not simply as an augmentation of the current revenue streams.

However, it should be noted that the means of accounting for the contributions derived from such funds can themselves be problematic, especially where a fund adopts an active investment strategy. The recent experience of many larger not-for-profit entities (for example the University of Sydney and the Sydney Anglican Diocese) demonstrates the importance of treating increments to value in marketable securities as non-permanent, and non-recurrent. Likewise, there is a need to identify the potential risk of a leveraged investment strategy for an organisation ultimately likely to have consistent and steady ongoing costs commitments.

6. PART FOUR - CONCLUSIONS

While there are some issues more likely to be encountered in the reconstruction of distressed non-commercial organisations, the approach to reconstruction is the same as that for "for-profit" entities. The idiosyncrasies of the legal framework, both in relation to the structure of the organisation and the method of formal external administration need to be considered on a case-by-case basis. To assist in this analysis, I have identified relevant resources below.

RESOURCES

LEGISLATION

Associations Incorporation Act 1984

Association Incorporation Act 2009

Co-operatives Act 1992

Corporations Act 2001

Registered Clubs Act 1976

Liquor Act 2007

REGULATORS

Australian Securities and Investments Commission

Office of Fair Trading

Office of Liquor and Gaming

INDUSTRY BODIES AND OTHER RESOURCES

Philanthropy Australia - website

OurCommunity – website

ProBono Australia – website

Managing in a Downturn – paper by PwC

Australian Bureau of Statistics Release 8106.0 Not-For-Profit Organizations, Australia 2006-2007

Productivity Commission Issues Paper April 2009 Contribution of the not for Profit sector, a paper released in anticipation of the Commission's final report, expected December 2009;

Senate Standing Committee on Economics' Report Disclosure Regimes for Charities and Not-For-Profit Organizations.

EXAMPLE

An example of a non-commercial organisation exhibiting many of the problems referred to in the paper is discussed in the attached article from the *Sydney Morning Herald* of 8 August 2009.