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Foreword

The exploitation of the non-profit sector for money laundering and, in particular, the financing of terrorism, is understood to have been a long-established practice. However, the methods and sources used by terrorist organisations to finance their activities became a key policy focal point after the terrorist attacks of 11 September 2001 and subsequent (predominantly government) examinations of terrorism funding substantiated the position that non-profit organisations were at an elevated risk of criminal exploitation. The vulnerability of non-profit organisations was related to their social purpose, the cash-intensive nature of their activities and the generally minimal form of regulatory oversight applied to their operations. Adding to this risk was the provision of services that relied on financial contributions and the good will of its supporters, the often regular transmission of funds between jurisdictions and less rigorous forms of administrative and financial management.

Chief among the policy responses was the inclusion of non-profit organisations in the Financial Action Task Force series of special recommendations to combat terrorism financing, to be observed by governments alongside the 40 Recommendations on the prevention of money laundering. Special Recommendation VIII (SR VIII) advised countries to review their laws and regulations regarding non-profit organisations to protect the sector from misuse by terrorist organisations posing as legitimate entities; through the exploitation of legitimate entities as conduits for terrorism financing and by concealing or masking the diversion of funds for legitimate purposes to terrorist activities. The Recommendation advocated increased transparency within the non-profit sector and the implementation of a regulatory scheme that included sector outreach, sector monitoring and effective intelligence and information gathering.

Abuse of the non-profit sector is evidently occurring at the international level but evidence from publicly available material assessed for this report indicated that the level of abuse of Australian non-profit organisations was comparatively low. Those organisations considered at greatest risk were charities, unincorporated organisations (ie those outside any type of formal regulatory control) and/or organisations that regularly used informal methods of funds transfer (such as alternative remittance services). These characteristics, however, did not necessarily match the handful of known (publically available) cases of Australian non-profit abuse, nor the greater spectrum of reported cases from the United States, United Kingdom and Canada, where the non-profit organisation was usually registered or otherwise known to a regulatory or tax authority and was built into a complex network of funds transfer that used, at some point, registered financial channels. This inconsistency in findings may demonstrate that criminal/terrorist elements were deliberately choosing to form or infiltrate registered non-profit organisations to instil a veil of legitimacy to the organisation's purpose and operation. Conversely, it may also show that detection is only practicable with formal or routine monitoring and hence non-profits sitting outside regulatory scrutiny are being exploited more than the case studies imply.

At present, the 'protection' of the Australian non-profit sector from exploitation combines elements of government- and self-regulation, along with education initiatives such as the Australian government-prepared guidelines *Safeguarding Your Organisations Against Terrorism: A Guidance for Non-profit Organisations* and peak body-generated codes of conduct. Protection is also afforded through the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth). Any designated service used or provided by the non-profit entity is

subject to reporting obligations as prescribed in the Act, including the submission of specified transactions to the Australian Transaction Reports and Analysis Centre, Australia's anti-money laundering and counter-terrorism financing regulator.

One of the mandates of anti-money laundering and counter-terrorism financing efforts is the implementation of measures that balance response with risk. To successfully mitigate the risk of abuse, the targeted sector must remain vigilant about potential vulnerabilities but the response should be both appropriate and proportionate to risk, and not produce undue burden. The regulation of Australia's non-profit sector has received numerous reviews and while it has not undertaken to examine risks as described here, the reviews have described a system that could benefit from reform. One option that has been proposed by the Australian Government is the implementation of a national regulator, alongside the soon-to-be-established Australian Charities and Not-for-profits Commission. The regulator, if modelled on regulators such as the Charity Commission of England and Wales, might provide the unified oversight currently absent in Australia. This report provides material on which policymakers, regulators, law enforcement agencies and the non-profit sector can base decisions regarding the potential and actual nature of risks to non-profit organisations and, if additional measures are deemed warranted, the application of responses that minimise risk without handicapping the sector's ability to perform its range of functions.

Adam Tomison
Director

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Consultations were also held with a number of government representatives and academics in the United Kingdom, Europe, the United States and selected countries in southeast Asia.

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Acronyms

ABN	Australian Business Number
ABS	Australian Bureau of Statistics
ACFID	Australian Council for International Development
ACNC	Australian Charities and Not-for-profits Commission
AIC	Australian Institute of Criminology
AML/CTF	anti-money laundering/counter-terrorism financing
AML/CTF Act	*Anti-Money Laundering/Counter-Terrorism Financing Act 2006* (Cth)
ARS	alternative remittance services
ASIC	Australian Securities and Investment Commission
ATO	Australian Taxation Office
AUSTRAC	Australian Transaction Reports and Analysis Centre
BIF-USA	The Benevolence International Foundation USA
CDPP	Commonwealth Director of Public Prosecutions
CRA	Canada Revenue Agency
Criminal Code	*Criminal Code Act 1995* (Cth)
DGR	deductible gift recipient
FATF	Financial Action Task Force
FBT	fringe benefit tax
FIA	Fundraising Institute Australia
FTR Act	*Financial Transactions Reporting Act 1988* (Cth)
GRF	Global Relief Foundation
GST	goods and services tax
GVA	gross value added
HLF	Holy Land Foundation for Relief and Development
IARA	Islamic American Relief Agency
ICAA	Institute of Chartered Accountants in Australia
IEEA	*International Emergency Economic Powers Act*

IRS	Internal Revenue Service
IRS-TEGE	IRS Tax Exempt and Government Entities Division
ITEF	income tax exempt funds
KYC	know your customer
LTTE	Liberation Tigers of Tamil Eelam
OFAC	Office of Foreign Assets Control
OSCR	Office of the Scottish Charity Regulator
NPOs	non-profit organisations
PVS	Partner Vetting System
SDN	Specially Designated Nationals
SR VIII	Special Recommendation VIII
TRO	Tamils Rehabilitation Organisation

Executive summary

The non-profit sector is characterised by the social purpose of its operations, its reliance on volunteers and the inherent trust placed in it by the larger community. The sector is also differentiated by traditionally having less in the way of regulatory control and a looser form of administrative and financial management. The latter is often a casualty of resource constraints and the need to fulfil commitments to the public to maximise the use of funds on charitable and other projects. It is these characteristics that purportedly make the sector particularly vulnerable to criminal and terrorist abuse.

The suspicion, followed by confirmation, that terrorist groups were using non-profit organisations (NPOs) to collect and distribute funds to finance terrorism spearheaded a range of counter-terrorism initiatives. Chief among these was the inclusion of NPOs in the Financial Action Task Force (FATF) series of Special Recommendations to combat terrorism financing, to be observed by governments alongside the revised 40 Recommendations around the prevention of money laundering (FATF 2004a, 2003a).

Special Recommendation VIII (SR VIII) advised countries to review their laws and regulations relating to NPOs in order to protect the sector from misuse:

- by terrorist organisations posing as legitimate entities;
- through the exploitation of legitimate entities as conduits for terrorism financing; and
- by concealing or masking the clandestine diversion of funds intended for legitimate purposes to terrorist organisations (FATF 2004a).

A mutual evaluation of Australia's anti-money laundering/counter-terrorism financing (AML/CTF) regime conducted in 2005 by FATF found that, with respect to NPOs, Australia had 'taken some measures to ensure...entities [were] not used to facilitate the financing of terrorism' but it had not introduced any additional measures to safeguard the sector from misuse (FATF 2005: 125). To better protect the sector, mechanisms such as more rigorous financial accounting, greater uptake of 'know your customer' (KYC) practices and broader regulatory oversight were suggested. Following the 2005 mutual evaluation, Australia implemented the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) (AML/CTF Act; under which the designated services of *some* NPOs now fall) and introduced guidelines and other educative initiatives to assist NPOs to undertake risk assessments and minimise exposure to money laundering/terrorism financing-related exploitation.

This report examines the risks to the Australian non-profit sector of money laundering and terrorism financing and describes the regulatory changes that could minimise risk. The report uses information derived from government, non-government and peer-reviewed literature, case law and regulator reports, and observations made by representatives from the non-profit sector, law enforcement and key regulatory agencies, and academia that were consulted for the study.

Typologies of risk

It has been proposed that the non-profit organisations at greatest risk of abuse are the charities. Charities are cash intensive, regularly transmit funds between jurisdictions (often to areas besieged by social unrest) and have historically operated under less formal regulatory scrutiny than for-profit entities. They are therefore seen an ideal vehicle in which to launder money or collect and transmit funds to finance terrorism activities.

Faith-based charities have been particularly targeted but all NPOs are potentially at risk. NPOs considered particularly vulnerable are:

- charities, or any non-profit organisation, that are small in size and hence less likely to have the resources to implement basic financial controls, let alone AML/CTF measures;
- organisations that sit outside conventional regulatory oversight; and/or
- entities that mostly use informal methods of funds transfer.

The risk to the non-profit sector in countries such as Australia, the United Kingdom, United States, Canada and New Zealand is nonetheless categorised as low, with the caveat that impact is inevitably high. Published typologies or case studies from these countries (and from various European nations and Russia) of non-profit misuse for money laundering or terrorism financing purposes are relatively small in number. It was not possible with the available information to resolve whether this represents actual prevalence of money laundering or terrorism financing, an underestimate in prevalence due to low detection rates, or merely the general absence of publicly available material.

The majority of typologies/case studies have focused on the exploitation of charities for terrorism financing; there is little documentation on exploitation of NPOs for money laundering purposes. The prevailing trend in the available typologies is that NPO misuse has come in the form of criminal or terrorist groups posing as legitimate charities, although it is not unknown for abuse to occur without the knowledge of the trustees and senior management, or of donors. In many cases, the charity was registered or otherwise known to some sector regulator or tax authority. The charity had often transmitted funds using registered, and hence detectable, financial channels. Complex systems of funds deposit, withdrawals and transfers using multiple accounts, and multiple forms of funds transfer, were developed to conceal the terrorism financing trail.

Risks to the Australian non-profit sector

Comprised of an estimated 600,000 organisations (Productivity Commission 2010), the Australian non-profit sector is characteristically diverse. It is made up of a broad range of organisations with different legal forms, different regulatory responsibilities and different capacities for complying with administrative and financial management practices originally developed for the for-profit sector. Three-quarters of Australia's NPOs are unincorporated; the rest consists of organisations incorporated under Commonwealth (ie *Corporations Act 2001* (Cth)) or, more commonly, state and territory law. Around 190,000 NPOs are registered with the Australian Taxation Office (ATO) for tax relief (ATO 2009). Charitable organisations are registered with state and territory authorities to gain fundraising licences.

Australian NPOs deemed at elevated risk of abuse are not unlike those described above, that is, charities (particularly those formed around faith or community groups), small, unincorporated entities and organisations that use informal funds transfer systems. None of these vulnerabilities are mutually exclusive and NPOs outside this cluster are not impervious to abuse either. Even larger, recognised and otherwise professional organisations can also be exploited. The greatest risk for these entities, and again charities and other fundraising bodies in particular, is the nature of the partner organisations responsible for the distribution of charitable assistance and the reliability of information collected (if collected at all) on these partners.

Evidence for the misuse of Australian NPOs for money laundering and terrorism financing is limited. Of the two prosecuted cases where it was known a charity (or charitable giving) was misused, one involved the fabrication of a charity to launder business-generated cash and the other the collection and disbursement of funds to a group engaged in both humanitarian and militant activities. The latter

case represents a challenge in the targeting of NPOs, as some proscribed groups genuinely provide health and welfare services as well as supporting terrorism. This, and cases in the United States, have considered whether apparently humanitarian intentions discounts guilt or charges of complicity in the support of terrorism.

Improving regulation

Another potential factor for NPOs and their exposure to criminal or terrorist abuse is how well the laws and regulations governing the non-profit sector are working to protect them from misuse. Australia's non-profit regulation has received three official reviews or inquiries between 2001 and 2010 (CDI 2001; Productivity Commission 2010; Senate Standing Committee on Economics 2008) and as many more informal appraisals (eg ACG 2005; Woodward & Marshall 2004). All have described the regulation of the non-profit sector as an overly complex system for entities and authorities alike and all prescribed reform. At present, NPOs may incorporate at the Commonwealth or at the state/territory level, receive tax concessions primarily from the ATO (but in some instances are eligible for tax relief through state tax laws) and require multiple licences if wanting to fundraise in different states and territories. Consequently, many NPOs are required to report multiple times to different authorities over the course of the financial year.

The absence of a more unified system of regulatory oversight, coupled with a lack of standardisation in financial reporting and accounting, not only burdens registered organisations with copious compliance obligations but potentially exposes the sector to misuse. Self-regulation, most recently in the form of codes of conduct, has worked alongside conventional regulation to ensure the sector is adhering to basic operating and risk management principles. One peak body has established a code of conduct with which applicable non-profit bodies can register and are monitored for conduct compliance. Nonetheless, it has been recommended in numerous reviews that Australia reform the regulation of the non-profit sector so as to streamline process, reduce the burden on the regulated component of the sector and minimise risk.

Of the options proposed in these reviews with which to improve regulation, the preferred approach is the establishment of a national regulator (Productivity Commission 2010; Senate Standing Committee on Economics 2008) to oversee some of functions currently dispersed across Commonwealth and state/territory authorities, *in combination with* self-regulatory functions currently performed by entities that have adhered to codes of conduct such as that prepared by the Australian Council for International Development. The government regulator, based on the Charity Commission of England and Wales and its replicates in the rest of the United Kingdom and New Zealand, would provide a one-stop shop for registration, fundraising approvals and endorsement for tax exemption status. If truly modelled on the Charity Commission, it would also be given statutory powers to investigate and deal with entities suspected of misconduct and work alongside law enforcement agencies in cases of more serious criminal abuse. NPOs with an annual income or assets over a set amount would be obligated to provide financial information to the regulator, parts of which would subsequently be made available to the public through an online register. NPOs would continue to be responsible for overseeing their operations as advised through codes of conduct and act to improve their adoption of risk and financial management strategies and, where relevant, AML/CTF measures.

The Australian Government released a consultation paper in January 2011 inviting comment on the form, scope and functions a national regulator might feasibly take (The Treasury 2011). It subsequently announced in the 2011–12 Federal Budget the establishment of the Australian Charities and Not-for-profits Commission (ACNC) which will have responsibility for determining charitable, public benevolent institution and other non-profit status, providing education and sector outreach and developing a simplified reporting framework (Australian Government 2011). Alongside the establishment of the ACNC, which will begin operating on the 1 July 2012, the government proposes to hold discussions with state and territory governments regarding the implementation of a national regulator for the non-profit sector.

NPOs have been advised through guidelines

prepared by government (eg the Attorney-General's Department) and peak bodies on what measures they should be following to minimise the risk of money laundering and terrorism financing occurring. The actual extent of adoption of such measures is unknown. Different stakeholders consulted for this report aired different views as to the proportion of NPOs that were aware of (or understood) money laundering/terrorism financing risks, or had done anything to minimise the potential for abuse to occur.

At present, the majority of NPOs do not undertake activities prescribed as a designated service under the AML/CTF Act and are hence not *obliged* to undertake AML/CTF risk assessments, implement due diligence procedures or report to Australian Transaction Reports and Analysis Centre (AUSTRAC) detection of certain transactions (eg suspicious transactions, transactions over specified thresholds and international funds transfer instructions). However, some protection against abuse is guaranteed by the fact that financial transaction activity involving an NPO should, in principle, be identified by the providers of other designated services the NPO uses to deposit and transfer funds. For example, banks may report suspicious transactions involving NPOs to AUSTRAC in appropriate circumstances.

Developing a response proportional to risk has been paramount in deliberations on how to best deal with the abuse of NPOs for money laundering and terrorism financing. Risk does exist for Australian NPOs, although the limited available public source evidence suggests that there has been little targeting of Australian entities and/or opportunity to establish sham operations. In recommending next-step responses, the apparent low risk of abuse must be evaluated against the contended weaknesses in the sector's administrative and financial management, the complexity of the regulatory system and the peripheral mechanisms that potentially promote misuse. Three areas of further research that would address these information gaps includes an analysis of non-compliance data to better identify weaknesses in non-profit financial operation and potential areas for exploitation, an evaluation of sector outreach/education strategies and the adoption of mitigation strategies and an examination of the use of informal funds transfer systems by at-risk entities.

Introduction

The penetration of the financial system by those who wish to use it for illegal purposes such as money laundering or the raising of finance for terrorism has been a concern for some time. The events of 11 September 2001 magnified these concerns and sponsored an almost immediate US-driven, but subsequently globally executed, re-assessment of the capacities and capabilities of terrorist organisations. More specifically, the manner in which such organisations financed their activities became, and continues to be, a key policy focal point. Although the financing for the 11 September 2001 attacks was obtained via wire transfers, physical movement of cash or travellers' cheques into the United States and the accessing of foreign based funds via debit and credit cards held in the United States (Roth, Greenberg & Wille 2004), the focus rapidly shifted to the original source(s) of those funds. The rationale and justification for focusing on the financial resources of terrorist organisations was deemed to be self-evident. As one US Government official noted just after the events of 11 September 2001:

> [F]inancial records and audits provide blueprints to the architecture of terrorist organizations. By following the money trail through financial information sharing worldwide, we can save lives by unearthing terrorist cells and networks (Zarate 2004: 1).

In the ensuing period, NPOs (specifically charities) were isolated as potentially significant contributors to terrorism financing. This summation was based on the belief that public or private funds may have been flowing from Saudi Arabia and other Middle East countries to terrorist organisations where al Qaeda raised money directly from individuals and charities (National Commission on Terrorist Attacks upon the United States 2004). It also rested on the suite of vulnerabilities characteristic to the non-profit sector, including purpose of operations, fundraising capacity, global presence, less rigorous financial management and due diligence practices, and weak regulatory oversight, which left it open to criminal and terrorist abuse.

Much of the literature since reflects this belief in the role of charities and other NPOs in terrorist financing. One report released in 2002 argued that 'for years, individuals and charities based in Saudi Arabia have been the most important sources of funds for al Qaeda' (Greenberg, Wechsler & Wolosky 2002: 1). Another source argued that money was often sourced from legitimate non-government organisations and charities (Ehrenfeld 2003). More tellingly, given its leading role in global anti-money laundering and counter-terrorist financing efforts, the FATF noted that:

> ...community solicitation and fundraising appeals are a very effective means of raising funds to support terrorism. Often such fundraising is carried out in the name of organisations having the status of charitable or relief organisations, and it may be targeted at a particular community... Specific fundraising efforts might include: the collection of membership dues and/or subscriptions; sale of publications; speaking tours, cultural and social events; door-to-door solicitations within the community; appeals to wealthy members of the community; and donations of a portion of their personal earnings (FATF 2002a: 4).

The rapidly evolving nature of terrorist groups as *learning organisations* (Jackson et al. 2005) makes it likely that the sources and nature of their funding may evolve as rapidly to suit changing geopolitical contexts. The ability of terrorist organisations to continue to utilise NPOs has arguably been facilitated by the apparent inability of international governments and financial institutions to agree to, and adopt, a common set of counter-terrorist policies with concomitant regulatory frameworks, targeting packages and penalties. There may, in consequence, be a degree of activity displacement or 'jurisdiction shopping' by terrorists and their financial supporters. Equally, the lack of a universal and coherent counter-terrorist response may lead to terrorists structuring their finances so as to exploit jurisdictional-specific advantages, such as the network of Gulf charities in the Middle East and weak financial regulation in key states in Africa and southeast Asia (Looney 2006).

It has long been posited that the increasing effectiveness of international efforts against money laundering vectors through the adoption of FATF measures (see below) is likely to increase the use of NPOs as conduits for funding to terrorist organisations (Looney 2006). However, it is argued that, despite the best efforts of the global community to impact upon terrorist financing, there remain a number of weaknesses in terms of a lack of coordination between international organisations, difficulties with the implementation of international standards at the national level and the burden of undertaking a risk-based approach for various non-government organisations. Even the apparent effectiveness of the US authorities in identifying connections between Islamic charities in the United States and terrorist organisations does not necessarily prevent those organisations from receiving funding from the same charities based, for example, in the Middle East where regulatory oversight is far less developed and/or less rigorously applied (Looney 2006).

Aims of the research

This report forms part of a four year research project undertaken by the Australian Institute of Criminology (AIC) examining a number of aspects of Australia's AML/CTF regime. The research presented in this report considers the risks posed to the Australian non-profit sector by activities such as money laundering and the financing of terrorism, and improvements that could be made to the regulatory response to minimise risk. To fulfil these aims, the research will examine the following questions:

- In what way can NPOs be used to facilitate money laundering and the financing of terrorism?
- Are specific types of NPOs (eg charities, unincorporated organisations) and forms of charitable giving (such as those based on cultural or religious systems of obligatory or voluntary charity) particularly vulnerable to misuse? What are the factors that make them more vulnerable to criminal or terrorist abuse?
- What is the evidence for actual corruption of NPOs by criminal and terrorist groups and how have these groups used NPOs to launder money and/or divert funds for terrorist purposes?
- How are NPOs regulated in Australia compared with four other countries—the United Kingdom, the United States, Canada and New Zealand—and how effective are current regulatory measures in preventing the use of such bodies for money laundering and financing of terrorism?
- What legislative, regulatory, educational and other measures are needed to reduce risks of money laundering and financing of terrorism involving charities and foundations?

The non-profit sector

A variety of terms are used to denote the non-profit (or not-for-profit) sector. 'Non-profit' refers to any organisation that is 'explicitly prohibited from distributing a profit and surplus assets when they are wound up' (Lyons 2001: 9). NPOs, along with 'cooperative enterprises' (eg friendly societies, credit unions), form what is designated the 'third sector', distinguishable from both the public or government sector and the for-profit business sector. Lyons has defined the third sector as:

> private organisations that are formed and sustained by groups of people acting voluntarily and without seeking personal profit to provide benefits for themselves or for others, that are democratically controlled and where any material benefit gained by a member is proportionate to their use of the organisation (Lyons 2001: 5).

The NPO component of the third sector comprises organisations that work in the broad areas of health, education, human services (such as women's, children's and disability groups), religion, arts and culture, sport and recreation, and philanthropy. It includes associations, charities, churches, clubs, foundations, societies and unions. The majority of these are what Lyons classified in an Australian Broadcasting Corporation Background Briefing report on the third sector as 'mutual, member-serving, member-owned organisations' ('Inventing the third sector' *ABC* 17 May 2009: np). Many NPOs operate within a local area, or within the one jurisdiction, and are run by local volunteers. However, the reach of other NPOs has expanded to operate either at the national level (often with local chapters) or to participate in overseas operations.

Size of the sector

The Australian third sector is estimated to encompass around 600,000 organisations (Productivity Commission 2010). Almost three-quarters (73%, n=440,000) of these organisations are small and unincorporated. Unincorporated organisations mostly function through voluntary contributions made by their members and are characterised by their small size, absence of employees and lack of legal status. Incorporated organisations make up the remaining quarter and comprise companies limited by guarantee, associations or cooperatives, or entities incorporated under specialised legislation (eg industrial legislation).

Estimates based on narrower classifications of the sector have been produced by the ATO and the Australian Bureau of Statistics (ABS). The ATO defines an NPO, for tax purposes, as:

> one which is not operating for the profit or gain of its individual members, whether these gains would have been direct or indirect. This applies both while the organisation is operating and when it winds up (ATO 2007a: 1).

According to the ATO's 2009–10 Compliance Program, there are around 190,000 NPOs registered with the ATO (ATO 2009). This group includes credit unions, building societies, multiple registrations and small non-employing organisations (Productivity Commission 2010).

The ABS employs the category of 'economically significant organisation', based on the International Classification of Non-Profit Organisations, to calculate the size of the sector. NPOs (or NPIs as the ABS labels them) are organisations that are:

- registered for an Australian Business Number (ABN);
- not-for profit and non-profit distributing;
- institutionally separate from the government;
- self-governing; and
- non-compulsory (ie membership or contributions of time or money are not enforced by law).

Applying this classification to ATO data, the ABS estimated there were 58,799 economically significant NPOs operating in Australia in 2006–07 (ABS 2009). This group excludes credit unions, building societies and body corporates included in the ATO categorisation, as well as those falling below the ABN turnover threshold of $150,000 or those which have chosen not to apply for an ABN (Productivity Commission 2010).

A suite of different measures have been published in estimating the economic contribution of Australia's NPO sector. A report predicting the impact of the global economic downturn on NPOs described the sector as employing upwards of 880,000 people and generating an annual turnover of $76b (The Centre for Social Impact, Pricewaterhouse Coopers

& Fundraising Institute Australia 2009). The consumer advocate group *Choice* estimated the sector to be worth five percent of Australia's gross domestic product (Dooley 2008).

According to the ABS Non-Profit Institutions Satellite Account, economically significant NPOs operating in 2006–07 employed 889,900 persons and received volunteering services from 4.6 million people. This equated to an estimated economic value of $14.6b (ABS 2009). The gross value added (GVA) generated by the sector on a national accounts basis was calculated at $19.7b in 1999–2000, increasing to $41b by 2006–07. GVA is the 'value of goods and services produced (or output), less the cost of goods and services used up in their processes of production' (ABS 2009: 35). This represented a 7.8 percent increase per annum in this sector's GVA.

Size of giving to the sector

NPOs are reliant on the provision of money, goods and services, largely from business groups and the community. The most recent analysis of the dynamics of giving found that in 2004–05, giving amounted to $11b a year in Australia (excluding donations to the Asian Tsunami appeal; Prime Minister's Community Business Partnership 2005). This total comprised:

- $7.7b from individuals ($5.7b from 13.4 million Australians plus $2b given by 10.5 million Australians through 'charity gambling' (eg fundraising from raffles, lotteries, art unions etc) or support for similar events); and
- $3.3b from 525,900 individual businesses (of which 68% came in the form of funds, 16% in goods and 16% in services).

Between 1997 and 2004–05, giving of money by individuals had increased in absolute terms by about 88 percent, or 12.5 percent per annum. In real terms, adjusted for inflation, giving rose by about 58 percent over this time period (Prime Minister's Community Business Partnership 2005).

With the recent economic downturn came predictions that this increasing trend in giving would start to reverse. A June 2009 survey of 263 NPOs operating in Australia found that three-fifths of organisations had experienced a decrease in income in the six months prior to the survey, and of these, 31 percent reported a decrease of 10 percent or more (The Centre for Social Impact, Pricewaterhouse Coopers & Fundraising Institute Australia 2009). Two-thirds of respondents anticipated a further decline in income in the following six months. Much of the decline already experienced came in the form of investment funding—90 percent of NPOs reported a drop in funds from this source. Two-thirds of NPOs also saw a drop in funding derived from fundraising, which in this survey included direct mail, cash, regular giving, corporate funding, trust, major donors and event fundraising. Fundraising made up, on average, 35 percent of the surveyed NPOs income. Corporate funding was the main casualty but 92 percent of NPOs also experienced either a drop (35%) or stagnation (57%) in cash donations (The Centre for Social Impact, Pricewaterhouse Coopers & Fundraising Institute Australia 2009).

A 2008 survey undertaken by *Choice* around charitable giving found that 81 percent of respondents did not know what proportion of their donation reached their favoured charity's beneficiaries, after fundraising costs and overheads were removed (Dooley 2008). Almost all of the respondents (94%) thought that it was important to have information about the proportion of those administrative and fundraising costs and 97 percent of respondents thought that it was 'very' or 'somewhat' important that they be provided with information about the effectiveness of charities' work. The underlying message reported by *Choice* from the survey results was that people wanted to know that their contributions to non-profit organisations were making a difference and having the most impact possible.

The meaning of charities

Much of the literature describing the actual and potential involvement of non-profit organisations in terrorism financing has focused on the role of 'charities'. However, as Lyons (2001) notes, charity is a 'confusing term' with its popular interpretation—'an organisation that raises funds from the public to provide relief to people who are disadvantaged because of poverty, ill health, disability or natural disaster' (Lyons 2001: 13)—encompassing only some of those organisations that the legal classification covers.

There is no statutory definition for charity in Australia, although the Australian Government recently announced its intention to introduce a statutory definition in consultation with the states and territories (Australian Government 2011). At present, its use in Commonwealth and state and territory legislation is based on the common law meaning or defining terms used in separate Acts (CDI 2001). The common law meaning derives from the Preamble to the *Charitable Uses Act 1601* (or Statute of Elizabeth) which lists designated charitable purposes, combined with a subsequent, additional stipulation that the purpose must be for the public benefit.

An entity is legally classified a charity if its purposes fall within one of four heads or divisions of charity:

- relief of poverty;
- advancement of education;
- advancement of religion;
- other purposes beneficial to the community (following *Income Tax Special Purposes Commissioners v Pemsel* [1891] All ER Rep 28 at 55; [1891] AC 531)).

Having a charitable purpose (no matter what the legal body form) will allow access to various tax concessions, fundraising licences and charitable gaming permits. The main types of legal bodies that can be deemed to have charitable purposes are:

- charitable trusts;
- unincorporated associations;
- incorporated associations;
- companies limited by guarantee; and
- some rare forms of bodies that are often unique charitable organisations (McGregor-Lowndes 2004).

One of the few instances in Australia where a concise definition of a charity is applied is the ATO's definition of charity for tax purposes. A charity endorsed by the ATO may be eligible for tax concessions or exemptions that are not available to other non-profit organisations. The ATO states that an organisation is a charity if:

- it is an entity that is also a trust fund or an institution that exists for the public benefit or the relief of poverty;
- its purposes are charitable within the legal sense of that term;
- it is non-profit; and
- its sole purpose is charitable.

Financial Action Task Force Special Recommendation VIII

FATF is an intergovernmental body formed in 1989 to prepare and promote policies and guidelines regarding the prevention of money laundering; in 1990, FATF issued 40 Recommendations on money laundering, which were revised in 1996.

The events of 11 September 2001 magnified concerns regarding both money laundering and the financing of terrorism. FATF consequently revised its 40 Recommendations (in 2003) and also issued Special Recommendations related to terrorist financing between 2001 and 2004. These Recommendations and Special Recommendations now form the internationally recognised standard for the prevention of money laundering and the financing of terrorism, and are used by FATF as a basis for their evaluation of the effectiveness of national regimes in addressing these issues.

With regard to the non-profit sector, the most relevant Special Recommendation is SR VIII. SR VIII advises countries to review their laws and regulations relating to NPOs, in order to protect the sector from misuse:

- by terrorist organisations posing as legitimate entities;
- through the exploitation of legitimate entities as conduits for terrorism financing; and
- by concealing or masking the clandestine diversion of funds intended for legitimate purpose to terrorist organisations (FATF 2004a).

The recommendation advocates increased transparency within the non-profit sector and improvements to public confidence with minimal disruption to legitimate charitable activity. NPOs are broadly defined by FATF as a:

legal entity or organisation that primarily engages in raising or disbursing funds for purposes such as charitable, religious, cultural, educational, social or fraternal purposes, or for the carrying out of other 'good works' (FATF 2004a: 21).

The recommendation goes on to state that an effective regulatory approach should include outreach to the sector, supervision or monitoring of the sector, effective investigation and information gathering, and effective mechanisms for international cooperation.

Subsumed within outreach activities is the recommendation that countries examine the application of identified best-practice methods to deal with risks and vulnerabilities of the non-profit sector to misuse by terrorism organisations. These best practices include:

- more rigorous financial accounting, including maintenance of full program budgets and use of independent auditing;
- establishment of registered bank accounts and use of formal or registered financial channels for transferring funds;
- verification of program specifics, such as transparent representation of solicitation for donations, audits of field and overseas operations, and general program oversight;
- routine documentation of administrative, managerial and policy control; and
- broadening the specified role or mix of oversight bodies (eg law enforcement, specialised regulatory bodies, and bank, taxation and financial regulatory authorities; FATF 2002b).

In 2005, FATF conducted a mutual evaluation of Australia's AML/CTF regime (FATF 2005). Mutual evaluations involve a peer-review process of a selected country's AML/CTF laws. This was the first evaluation that used the current 40 Recommendations and Special Recommendations as a basis for evaluation. This mutual evaluation highlighted a number of perceived deficiencies in Australia's arrangements regarding the regulation of the non-profit sector. The mutual evaluation noted that Australia had a large non-profit sector which was subject to differing forms of regulation depending upon what sort of non-profit body was involved. It also noted that while Australia had reviewed the operations of the sector, it had not introduced any additional measures to further safeguard the Australian non-profit sector from misuse by terrorist groups, in particular ensuring against terrorist organisations being able to pose as legitimate entities, or funds and other assets being diverted to support terrorism (FATF 2005). The mutual evaluation suggested that Australia consider the possibility of introducing some of the best practice measures (listed above) FATF had proposed with regard to SR VIII. Following the 2005 mutual evaluation, Australia implemented the AML/CTF Act (under which the designated services of *some* non-profit organisations now fall) and introduced guidelines and other educative initiatives to assist non-profit organisations to undertake risk assessments and minimise exposure to money laundering/terrorism financing-related exploitation.

The anti-money laundering/ counter-terrorism financing regulatory regime in Australia

Australia has a complex legislative regime relating to various aspects of money laundering, the recovery of proceeds of crime and the financing of terrorism. Much of this legislation is quite recent and aspects of it are still being revised and extended. Recent commentators have divided Australian legislation regarding money laundering into three categories (Deitz & Buttle 2008: 37–38):

- criminal offences relating to money laundering, which at the federal level are contained in the *Criminal Code Act 1995* (Cth) (Criminal Code) and also in various state and territory Acts;
- proceeds of crime legislation, which is in place at the federal, state and territory level; and
- prevention and detection measures for money laundering (and now the prevention of terrorism), which were initiated in the *Financial Transactions Reporting Act 1988* (Cth) (FTR Act) and which are now provided for (and in some areas extended) by the AML/CTF Act.

The AML/CTF Act came into force on 12 December 2006. The AML/CTF Act covers both industry

sectors with obligations under the FTR Act, including the prudentially regulated financial sector and a range of other designated businesses. The sectors (and the designated entities within each regulated sector) currently regulated under the AML/CTF Act are as follows:

- banking (banks, building societies, credit unions, finance corporations, friendly societies, housing societies, merchant banks, SWIFT);
- alternative remittance (corporate remitters, remittance providers);
- securities/derivatives (futures brokers, mortgage and finance providers, securities dealers);
- managed funds/superannuation (investment companies, managed funds, principle or discretionary, traders, retailers, superannuation trusts, unit trusts);
- gambling (casinos, gambling houses, on course bookmakers, pubs and clubs, sports bookmakers, TABs);
- foreign exchange (foreign exchange providers, payment service providers, postal and courier service providers, travel agents, travellers cheques issuers); and
- financial services (factorers, forfeiters, hire purchase companies, lease companies, pastoral houses, public authorities).

The Australian Government is currently examining the need to extend the application of the AML/CTF Act to specified services provided by a number of other business and professional sectors. The sectors that are likely to be regulated in this second tranche of legislative reforms in Australia include lawyers, accountants, real estate agents, dealers in precious metals, trust and company service providers. Until the second tranche of legislative reforms is enacted, it cannot be determined with accuracy which professionals and which of their services will be regulated and to what extent. For further description of the AML/CTF regime in Australia, see Walters et al. (2011) and Smith et al. (forthcoming). The majority of NPOs do not provide services prescribed as a designated service under the AML/CTF Act.

Methods and report outline

The findings presented in this report combines information drawn from:

- a review of peer-reviewed, government and non-government literature;
- an examination of case-law, regulator reports and other sources of information on investigated cases;
- roundtables with representatives from Australian law enforcement and regulatory bodies, academia and the non-profit sector; and
- consultations conducted in the United Kingdom with regulators, academics and representatives of peak non-profit bodies.

The project was approved by the AIC Human Research Ethics Committee on 19 August 2009.

The next section of the report examines the proposed role of NPOs in money laundering and terrorism financing, the vulnerabilities specific to the non-profit sector and the apparent targeting of charities, particularly Islamic charities. The following section categorises methods of misuse before describing the evidence available for actual exploitation of NPOs. Examples are drawn from suspected and confirmed cases, and published typologies, investigated in the United States, United Kingdom, Canada, Europe and Australia.

Models of non-profit regulation and the effect of AML/CTF policy on regulation are discussed in the penultimate section, to illustrate the varying approaches taken to regulate and monitor the sector and demonstrate the inherent difficulty in coordinating whole sector capture. The section also addresses self-regulation (the preferred regulatory model among the sector) and summarises sector misgivings around proposed and already executed changes to regulation that were influenced by AML/CTF policies.

The final section discusses the importance of quantifying risk when developing preventative or mitigation strategies and outlines where the Australian non-profit sector is potentially exposed. In concluding the report, consideration is given to the suite of options that might be adopted in Australia to both improve current regulatory shortfalls and deliver a proportionate response to the variable money laundering/terrorism financing risk experienced among Australian NPOs.

The role of non-profit organisations in money laundering and terrorism financing

The utilisation and exploitation of the non-profit (and specifically charitable sector) by terrorist groups is understood to have been a long-held strategic position (Winer 2008), although little, if anything, has been said about the connection between NPOs and money laundering. For this reason, much of the following focuses on the exploitation of NPOs for the financing of terrorism. al Qaeda (and its predecessor Mekhtab al Khidemat), for example, had been particularly successful in exploiting Islamic charities and other NPOs (Kohlmann 2006; National Commission on Terrorist Attacks upon the United States 2004). The IRA too has had a long history of funding its paramilitary activities with charitable support, sourced from private donations and funds collected in local pubs and clubs and contributions raised overseas by so-called 'support' groups such as the Irish-American NORAID (the Northern Aid Committee) and FOSF (Friends of Sinn Fein). Other notorious groups associated with exploiting charitable relief include Hamas, Hezbollah, the Liberation Tigers of Tamil Eelam (LTTE) and Jemaah Islamiyah (Abuza 2009, 2003; Croissant & Barlow 2007; Flanigan 2008; Ghandour cited in Ly 2007; Gunning 2008; Levitt 2006, 2005). Recently, with the devastating 2010 floods in Pakistan, there were accusations that charitable relief was being controlled and distributed by a 'hardline Islamist charity' called Jamaat-ud-Dawa, linked to the terrorist attacks on Mumbai in 2008 (Crilly 2010; Sara 2010).

In the significant activity focused on understanding how the terrorist attacks of 11 September 2001 were executed, however, the already acknowledged relationship between NPOs and terrorism financing was given greater credence. During that period, a range of NPOs including:

> charities, humanitarian organizations, social justice movements and international solidarity groups [were] seen as particularly suspicious in terms of concealing or providing terrorist financing and [were] therefore targeted by the combating of financing of terrorism measures (McCulloch & Pickering 2005: 472).

While all NPOs were potentially under observation, the charitable sector became the *raison d'être* of counter terrorism activity. This was because there was (and is) a seemingly logical connection between fundraising and exploitation of those funds for illegitimate purposes. In announcing the adoption of executive order 13224—which froze assets of individuals and entities suspected of being linked to terrorism—the then President Bush asserted that 'international terrorist networks make frequent use of charitable or humanitarian organizations to obtain clandestine financial and other support for their activities' (US Government Printing Office 2001:

1363). In 2002, HM Treasury noted that evidence was available to show that charities had indeed been involved in the financing of terrorism (HM Treasury 2002) and more recently, the UK government argued that:

> while the scale of terrorist links to charitable activity is extremely small in comparison to the size of the charitable sector, the risk of exploitation of charities is a significant aspect of the terrorist finance threat (Home Office & HM Treasury 2007a: 52).

The Australian Government has also acknowledged the generation of terrorism funds through charitable fundraising (O'Connor 2009).

While there is widespread acceptance of the role of NPOs in terrorist financing (and presumably money laundering; eg see Amador 2008; Croissant & Barlow 2007; Ehrenfeld 2003; Greenberg, Wechsler & Wolosky 2002; Lee 2002; Levitt 2006, 2005; Looney 2006; Winer 2008), some commentators, while not disputing the link, have cautioned against overstatement. Benthall (2008, 2007a, 2007b) has been particularly critical of the possible (if not probable) misinterpretation of the evidence, which he considers to be the product of the use of questionable sources, less than rigorous assessment of available intelligence and observer bias. Others have argued that the confusion and distress over the series of terrorist attacks in the early to mid 2000s would inevitably lead to the axiom of 'when you are caught in the headlights, all oncoming vehicles tend to look like juggernauts' (Briggs, Fieschi & Lownsbrough 2006: 13). In the subsequent approach to counter-terrorism financing, the *potential* for abuse has come to outweigh the volume and logistics of *actual* abuse.

Vulnerability to misuse

Proving the equation that NPOs are almost bound to be abused seems relatively straight forward. Their vulnerability is related to a broad range of factors related to sector reputation, the areas in which they work and the nature of their organisational structure, governance arrangements and methods of financial management (Charity Commission 2009a; Cooper 2009; FATF 2004a, 2004b). Some of the vulnerabilities pertinent to the non-profit sector are that NPOs:

- engender high levels of public trust, are relatively easy to establish and highly diverse in nature. The sector has traditionally attracted less suspicion due to the altruistic nature of its work;
- may have a global presence, are often situated or operate within areas of conflict and regularly depend on intermediary partners or local branches to deliver funds and services, sometimes without direct supervision or control;
- are usually cash intensive and might be constituted by complex global financial operations involving multiple donors and currencies;
- sometimes use processes for collecting and transferring funds that are highly informal, not always regulated and facilitated through personal networks;
- tend to minimise spending on internal administration and management due to limited financial resources and to maximise funds for their or charitable projects;
- invest less in regulatory compliance practices and obligations relating to due diligence, often because resources prevent implementation or adherence to strict financial controls. On occasion in some organisations, there may be poor management of accounts and verification of legitimacy and legality of recipient organisations and their use of donated funds may be overlooked; and
- are subject to quite different levels of regulatory control depending on the region they operate in, affecting reporting requirements and the type and level of scrutiny given to them.

The interchangeable nature of charitable donations

Charities, in particular, are thought to provide terrorists with the ideal vehicle with which to both generate support for their activities and propagate their particular ideologies. Charities, through their ability to attract large numbers of donors and increase public advocacy and support, are veritable wellsprings for raising funds (Winer 2008). Since fundraising can take in a variety of forms, such as

> the collection of membership dues and/or subscriptions; sale of publications; speaking tours, cultural and social events; door-to-door solicitations within the community; appeals to wealthy members of the community; and

> donations of a portion of...personal earnings (FATF 2002b: 4)

the potential for gathering large sums of money is increased. It has been suggested that

> there exist many examples of organizations which, in addition to their violent activities, devote significant time and resources to take care of the poor in a more or less institutionalized way (Ly 2007: 180).

So-called 'asset substitution', where funds are interchanged between legitimate and illegitimate uses, is seen as a particular issue and is carried out by groups such as Hamas, Hezbollah and the LTTE. These groups are recognised as sponsoring a combination of humanitarian and terrorist activities. Hamas plays a critical role in the provision of health, educational and other social welfare services in the West Bank and the Gaza Strip, distributing up to 95 percent of their funds to NPOs working in the Palestinian territories (Ghandour cited in Ly 2007). Hezbollah is responsible for a wide network of charities and other NPOs and the LTTE is well known for its investment in NPO activities (Flanigan 2008). Donations made to these and similar groups may be done with the assurance, if not the conviction, that the funds will not be diverted to support acts of violence. Nonetheless, there exists the charge that even where an NPO is conceded to be providing humanitarian aid, financial support for the NPO still supports terrorism because the NPO is freed up from having to meet costs and can therefore use donated funds for military purposes. It is such donations that have featured heavily in the international counter-terrorist response because it cannot easily be demonstrated that money collected ostensibly for charitable or aid purposes in one state is not re-routed to terrorist endeavours against another.

Faith-based giving and the targeting of Islamic charities

Notwithstanding the wider assumption that all NPOs are at potential risk of abuse by terrorist groups, faith-based charities and notably Islamic charities, have come under particular scrutiny. Part of the rationale for this individualised attention is that within some religions, regular charitable giving to the poor and disadvantaged is a fundamental obligation of the faith—an obligation perceived as being open to exploitation. The figure of how much is given differs between faiths; however, it is generally calculated on a fixed rate of the individual's annual income or annual savings. Systems of transferring funds for this purpose can be highly informal. Many donors rely on their community network to both nominate a cause and transmit funds on their behalf. While this process allows for individuals to save on bank transfer fees by sending their contributions together in the one transaction, the process is highly unregulated and allows for minimal transparency and accountability.

Faith-based giving is not unique to any one religion, but in most the practice is encouraged rather than one of obligation. The obligation to give is most clearly articulated in the practices of *tzedakah*, *zakat* and *sadaqah*.

Tzedakah

Tzedakah is one of the three acts that allow Jews to gain forgiveness from their sins. According to Jewish law, one-tenth of an individual's annual income must be given to the poor. This is generally interpreted as one-tenth of net income after payment of taxes. The obligation to perform *tzedakah* can be fulfilled by giving money to the poor, to health care institutions, to synagogues or to educational institutions. It can also be fulfilled by supporting your children beyond the age when you are legally required to, or supporting your parents in their old age. The obligation includes giving to both Jews and gentiles (ie those not of the Jewish faith).

Zakat and sadaqah

In Islam are the practices of *zakat* and *sadaqah*. *Zakat* is one of the five pillars of Islam, that is, one of the five obligatory duties bestowed on each Muslim. *Zakat* means 'purity' or 'purification' and refers to the system that organises the transfer of wealth to the poor; it requires individuals to annually tithe at least two and a half percent of their wealth to the needy. The Qur'an notes (9:60) that eight categories of people are entitled to receive *zakat* including the poor, the needy and the wayfarer. The value of *zakat* generated worldwide is estimated to be in excess of $200b (Crimm 2008). *Sadaqah* is the practice of voluntary charitable giving but unlike *zakat*, non-Muslims may also be recipients of this form

of charity. Both *zakat* and *sadaqah* are to be given anonymously to ensure that the act remain virtuous.

In addition to *zakat* and *sadaqah* are a variety of compulsory and voluntary mechanisms through which charitable donations are made at specific times of the year. Thus, there is *Zakat el Fitr* (requiring donations at the end of Ramadan—the month of fasting), *Wakf* (the giving of continuous alms) and *Kafaara* (easing of sin), which allows a Muslim who has committed particular sins to mitigate them through the performance of a charitable act (Ndiaye 2007). In essence:

> the flow of funds by means of *zakat* and *sadaqah* contributions…is an essential building block for Muslim civil societies. Thus, the various mechanisms by which, or through which, such assets are channelled are core to, and a critical part of, those civil societies. There is much evidence that these philanthropic and charitable structures perform not only an economically integral function in Muslim civil societies, but that they also are socially, culturally, and politically institutionalized (Crimm 2008: 587).

The susceptibility of Islamic charities

When the cultural and religious drivers of *zakat* and other funding mechanisms and the ideology behind many of the terrorist attacks of the last two decades are factored in, the targeting of Islamic charities was perhaps inevitable, even if not always justified. Indeed, it seemed such an obvious conduit that to suggest that such might *not* be the case could be construed by some as counterintuitive. It has been suggested that the obligatory charitable donations of *zakat* represent the largest single source of [charitable] revenue diverted to terrorist groups (Rudner 2006).

Alongside the predicted precursor of cultural obligation are factors around transparency and accountability that are purported to reinforce the risk posed by Islamic charities. These factors relate to the differential structure of the collection units or agencies, the manner in which the funds are disseminated and the general absence of government oversight. Historically, *zakat* funds operated at a local level but more recently, national and international *zakat* funds have been established that distribute funds directly to individuals and non-governmental social welfare organisations (Crimm 2008). Funds were traditionally channelled through Islamic charities, mosques and other agents but in order to meet their various charitable obligations, Muslims have elected to create institutions tasked with the collection, administration and distribution of charitable donations. The best known of these are *zakat* committees but other vehicles include *waqf* (an endowed perpetual trust fund) which comprises two main types, namely, family (created to protect family assets) and charitable (created to meet broadly defined charitable aims including the building of mosques, madrassas, roads, hospitals and orphanages; Crimm 2008). *Awqafs* are still present in India, Iran, Bangladesh and Pakistan and are exempt from secular taxation.

It is clear, as with a number of secular charities, that not all Islamic charities are constituted by the same or even similar structural and organisational characteristics. Thus, some charities are local branches of international NPOs and others are local groups or Islamic centres or foundations attached to, or associated with, a specific local mosque. Consequently, the manner in which respective charities operate in terms of the activities and programs in which they engage, the financial procedures they employ and the methodologies utilised to distribute funding may differ significantly. This divergence naturally renders it difficult to trace and monitor the nature, volume and distribution of funds (Ndiaye 2007).

The systems of collection listed above continue to be used by Muslim communities in addition to informal value transfer systems such as *hawalas*. A *hawala* acts as an alternative remittance scheme and has been a focus of concern because of its suspected and known role in transferring terrorism funds (Croissant & Barlow 2007; Roth, Greenberg & Wille 2004). At the most basic level of *hawala*, the remittance process involves four participants—a sender, a beneficiary and two intermediaries. The sender approaches an alternative remittance service (ARS) agent in their jurisdiction and advises how much they want sent, to whom and in which jurisdiction the recipient resides. The ARS agent then contacts another agent in the recipient's jurisdiction and requests that they pay them the requisite sum. Reflecting more current banking practices, no money changes hands. Following the transaction, the first ARS agent is indebted to the second ARS agent. However, it is likely that an ARS agent would

be involved in a number of transactions at any given time and have links with many other ARS agents, therefore having multiple debts.

The informality, efficiency and anonymity of *hawala* (and other versions of alternative remittance schemes) makes it susceptible to misuse and being largely unregulated, does not produce the paper trail needed to detect suspect transfers of cash. The amount of money that is transferred through *hawala* is not known, although some estimates suggest it is in the billions or tens of billions of US dollars (US Department of the Treasury 2002). The AIC examined the nature and use of community-based alternative remittance in Australia, in a broader study on characteristics of alternative remittance businesses in Australia, the risks they posed and some of the current responses to those risks (see Rees 2010a, 2010b and final section of this report).

An additional risk factor to Islamic charitable giving is the typical anonymity of the donor and the sanctioned recipient of such giving. The Qur'an considers those who bestow *zakat* and *sadaqah* contributions anonymously to be especially pious. In that context, tracing the volume and source of such donations is bound to be problematic. The Qur'an also stipulates that 'charity shall go to the poor who are suffering in the cause of God…' (2: 273). Thus, the recipients of charity are broadly drawn and subject to a degree of interpretation which has impacted perhaps negatively upon the manner in which charitable donations have been directed and which may have exacerbated the perception that Islamic charities provide succour to terrorist organisations (Ndiaye 2007).

Finally, the religious driver behind *zakat* and *sadaqah* has meant there has been little or no official government oversight of the process. Given the transparency requirement placed upon charitable giving per se, religious donations are inevitably going to come into conflict with this increasingly prevalent norm of accountability (Looney 2006). It is argued that *zakat* is often provided in cash to prominent community leaders who disperse it to persons and charities they deem worthy of receiving it.

The picture is rendered more complicated by the fact that in a number of countries that lack an established and functioning income tax system (such as Saudi Arabia and the United Arab Emirates) *zakat* donations might comprise the principal funding source for a range of religious, social and humanitarian organisations (Looney 2006). The apparent reluctance on the part of a number of jurisdictions to subject charitable organisations to rigorous scrutiny has led, it is suggested, to a proportionate increase in the attractiveness of such organisations to terrorist groups.

Conclusion

The vulnerability of the non-profit sector is a product of factors related to organisational structure, method of operation, fund distribution networks and financial management practices. However, its ultimate vulnerability lies with its social role and the inherent trust it holds with the larger community. Embedding operations into the activities of an organisation that commands responsibility and trustworthiness is the ideal cover for criminal activities.

Among the sector, it is the charities that have been judged at greatest risk. Charities not only provide a means of generating funds but also of concealing its diversion. Donors that are both witting and unwitting, supply a steady stream of funds that may be bequeathed anonymously due to cultural or faith-based reasons. Verification inquiries around the destination and use of donations are moderated by community confidence in the charities intentions. Funds collected on the pretext of charitable use can then be re-routed to the intended recipients, or divided between charitable and terrorist support. The latter course can act to reinforce terrorist operations, by cultivating sympathies and developing recruitment grounds for the next cohort of militants.

Charities or similar organisations present similar opportunities for money laundering. Illegally obtained money can be concealed as donations and cleansed by the legitimacy and credibility of the organisation it is being passed through. If the charity is operating in an environment devoid of regulatory control, or manages its activities so that they fall outside scrutiny, both realistic scenarios, the deception is made all the more easier.

Misuse of the non-profit sector

The potential abuse of the non-profit sector lies in the fact that

> just as with any other mechanism for collecting, moving and distributing funds...the basic model of a [non-profit organisation] is exposed to the risk of terrorist exploitation [or other criminal behaviour] through either the creation of an entirely bogus entity or the abuse of a legitimate organisation (Home Office & HM Treasury 2007a: 10).

Typologies of misuse generally encapsulate two modes of involvement (Weber 2008). First, NPOs may be used to raise funds and/or serve as channels to transfer funds within and between jurisdictions. NPOs can also provide cover, or direct logistical support for the movement of other resources (such as arms) and operatives (FATF 2008a, 2004b; Weber 2008). In addition, NPOs may play a part in the diversion and control of funds to 'recruit members and foster support' for a terrorist organisation and their ideology (US Department of the Treasury 2006a: 2).

Categories of misuse

Misuse of funding

Funds may be collected in the name of an established and legitimate NPO but disbursed for terrorist rather than altruistic means (FATF 2008a, 2004b). If funds collected by a reputable NPO are disbursed overseas (which, given the level and range of recent humanitarian crises, is likely) they could be diverted en route or in situ by terrorist organisations or their agents. Equally, wittingly or otherwise, an NPO may be used as a money laundering vehicle or as a means of transporting cash from one jurisdiction to another. Where an NPO's financial controls are weak, the risk of such abuse may be heightened.

Misuse of assets

The physical attributes of NPOs, such as vehicles and premises, might be exploited to transport people, money or weapons and/or store such items, respectively. Members of a terrorist organisation might gain unfettered access to a country or region on the false basis that they work for an NPO known to that country or region. Taken to extreme, it might be possible to purport to be operating on behalf of an NPO in a jurisdiction within which terrorist training is being orchestrated. The essential communication links created and/or utilised and/or maintained by NPOs might be exploited by terrorist groups for the purposes of establishing and maintaining their own contact points (Charity Commission 2009a).

Misuse of the non-profit organisation's name and status

An NPO may provide financial support to an organisation that provides humanitarian aid but that organisation may also provide succour to terrorist activities (Charity Commission 2009a). Alternatively, an NPO may raise funds for a particular cause but have those funds dispensed or support provided through a terrorist group (FATF 2008a). This is the perception held of a number of a charities operating in Palestine, for example, and their association with Hamas.

Misuse of an non-profit organisation internally

Members of an NPO may abuse it from within by, for example, 'skimming' money off donations received and disbursing those funds for terrorist activities (Charity Commission 2009a). Equally, those members may allow the NPO's premises to be used for holding meetings or production of propaganda material. Trustees of the NPO may engage in pro-terrorist speeches or activities and/or may invite speakers or utilise volunteer workers whose views are likely to lead to the promotion of extremist views.

Misuse of the notion of non-profit organisation/charitable status

It is possible that a terrorist organisation may elect to establish a sham NPO, but one which is registered and engages in the requisite regulatory requirements. In this context, donations can be legitimately requested, processed and disbursed. It could, if managed effectively, employ a range of legitimate staff who may be unaware of the true nature of the source of donations or the ultimate terrorist-linked destination of the accrued funds (Charity Commission 2009a). This type of misuse may be achieved in the following ways:

- NPOs may be used to raise funds for terrorist organisations and transfer funds and other resources across borders using NPOs with a known international remit for this purpose;
- NPOs could be defrauded at branch level or via aid workers with budgetary responsibility and/or control; and
- funds can be leveraged so as to facilitate the recruitment of members from whom support for terrorist organisations and their ideologies can be garnered (US Department of the Treasury 2006a).

Risk indicators for terrorist abuse

When the sheer diversity in terms of size, income and activity within the NPO sector is taken into account, it can be seen that the nature of the risk varies across the sector and changes not only with size but also with objective and function. Thus, for example, an NPO that transfers funds globally to support aid in conflict zones may be at equal risk of abuse as a domestic organisation with limited assets but formalised links with groups driven by an extremist ideology. The risk of an NPO falling victim to terrorist exploitation may be greater for groups that:

- are closely aligned to particular religious or cultural movements;
- move funds or other resources frequently to areas of conflict;
- provide funds to other overseas-based organisations rather than deliver the funds directly;
- deal in cash or alternative remittance systems where no formal banking infrastructure exists; and/or
- have extremely complicated financial records in which suspicious transactions are less easy to identify (Home Office & HM Treasury 2007a).

An NPO with one or more of these characteristics does not predetermine involvement in money laundering or terrorist funding but rather increases the risk of abuse compared with an NPO not defined by such characteristics.

Evidence for misuse

The designation of NPOs as a possible source and conduit for money laundering or terrorism funding correspondingly fostered a number of government or sector-led reviews to ascertain overall risk to the sector. While the risk of an NPO falling victim to terrorist exploitation was deemed to be relatively low, at least in the United Kingdom, Canada and New Zealand (Charities Commission 2010a; Charity

Commission 2009a; CRA 2010; Home Office & HM Treasury 2007b), the nature or components of the existing regulatory system and financial management practices were seen as contributing to the potential exploitation of the sector by terrorist and other criminal elements. The regulation of the non-profit sector and changes made to regulation to offset risk of fraud, money laundering and diversion of funds to terrorism, will be discussed in the next section.

A UK survey of risk management within charities, in the context of the economic downturn, noted that in terms of a number of key risk management components, the charitable sector was opening itself up to potential abuse (PKF and the Charity Finance Directors' Group 2009). This decline in the application of risk management standards was arguably exacerbated by a lack of knowledge of the external (including terrorist financing) environment (noted by 55% of respondents), a lack of rigour in the risk management process (47%) and a failure in risk mitigation (45%). The absence of even the basics of financial management—the development of fraud prevention and whistleblowing policies, execution of internal controls and regular monitoring—left many charities unnecessarily vulnerable to an increased threat of misuse (see Table 1). It was argued that the recipients of funds could misuse them if appropriate due diligence checks had been carried out ineffectively, or not at all, by the charity upon those recipients (PKF & the Charity Finance Directors' Group 2009).

Another UK-based report, by the Charity Commission (2009b) of key themes that emerged during the course of compliance work, revealed evidence of abuse of charities, particularly in two areas where the potential for terrorist abuse exists. In terms of financial mismanagement, poor financial management and reporting were deemed to be significant problems as were a lack of financial controls, inadequate accounting and record keeping, and a failure to submit accounts. Fraud, theft and significant loss of funding were deemed to be common features of regulatory investigations undertaken (Charity Commission 2009b). Equally, in terms of trustees, cases were noted where individuals were not legally entitled to act as a trustee, or where there was inadequate management and oversight by trustees of the charities with which they were involved. There was also a failure in the performance of both individual trustees and of trustee boards to ensure that effective governance and proper control mechanisms were in place.

Inconsistent results concerning the abuse of charities arose from a 2008 OECD survey of charities in 19 (mostly European) countries (see Table 2). Abuse in this report referred to instances of tax fraud that were perpetrated by taxpayers, donors, or third parties; the latter cases involved persons or entities that had fraudulently posed as a charitable organisation or preparers of tax returns who had engaged in falsifying tax return statements. The abuse that was detected was considered to be organised rather than improvised and where the economic cost or level of tax evasion or money laundering could be estimated, the impact was described as substantial (OECD 2008).

Australia has not conducted a similar examination of financial management in the non-profit sector, other than to produce guidelines that include best-practice

Table 1 Risk management strategies in the charitable sector, 2009

Risk vector	%
No risk policy	30
No risk register showing controls	20
No business continuity plan	46
Do not test operation of their internal controls	51
Do not have a fraud policy	57
Do not have a whistleblowing policy	41

Note: 466 charities were surveyed

Source: PKF & the Charity Finance Directors' Group 2009

Table 2 Instances of tax evasion, tax crimes or money laundering involving charities

Country	Response
Argentina	No detected suspicious money laundering transactions involving charities
Austria	Since the scope of tax reducing donations is very restricted by Austrian tax law, no experiences of systematic tax evasion and money laundering have been gained yet
Belgium	Tax audits sometimes uncover instances of abuse. These cases mainly involved the issuance of tax receipts in no admissible situations or for funds that were not donations. A few registered organisations were the subject of legal investigations
Canada	Detected instances of tax evasion, tax crimes and money laundering involving charities
Chile	No relevant instances of tax evasion, tax crimes or money laundering involving the abuse of charitable contributions
Czech Republic	Regarding money laundering, around three to five suspicious transactions concerning subjects that come from the non-profit sector are identified by the Czech FIU (Financial Analytical Unit of the Ministry of Finance of the Czech Republic) yearly. No specific statistics on charities and tax evasion were available
Denmark	Only one case—but the charitable entity was acquitted in court
France	No cases of money laundering, tax evasion or tax crimes have been detected among NPOs through monitoring operations by the Direction Nationale des Enquêtes Fiscales [National tax investigations directorate]
Germany	None
Ireland	Instances of tax evasion/avoidance have occurred periodically in an ad hoc way. Occasionally, an audit/review has discovered an interpretation of the rules of the scheme that differed somewhat to the revenue's view and the terms and perhaps the conditions of the tax exemption have not been strictly adhered to. This activity would not constitute a crime or money laundering
Italy	Some instances of tax evasion have been identified involving non-commercial entities and ONLUS (Organizzazione Non Lucrativa di Utilita' Sociale)
Netherlands	Only one case has been detected in which a charity was involved in tax crimes; however, the investigation was stopped. Another case was detected from a tax audit which revealed that employees and directors took money from the charity for personal use. Overall, not a lot of abuse of charities has been discovered
Norway	No indications of tax fraud related to the deduction of contributions to charities. The system has, in some cases, revealed crimes related to charities
Portugal	No situations of tax evasion or money laundering in connection with non-profit entities have been identified. Foundations may, on occasion, be used for assets acquisition or exempted commercial operations without respect to the underlying conditions, for example, the obligation to allocate part of the company's revenue to social aims
Spain	Certain people, related to charities, have accumulated great amounts of money that have been sent to tax haven territories. An investigation is looking to find the source of that money
Sweden	The Swedish Tax Agency has identified tax evasion and money laundering involving NPOs of different kinds. There are no specific suspicions of tax offences or money laundering in the NPOs taking care of charity donations. There are frauds, for example cheating the donors by stealing the donations, but there are very seldom tax implications
Turkey	MASAK (Financial Crimes Investigation Board) has not identified any money laundering offences involving charities in Turkey
United Kingdom	The UK tax authorities have identified instances of tax evasion and tax crimes involving charities. There is no firm evidence of money laundering although it is suspected
United States	The United States has identified instances of tax evasion, tax crimes and money laundering involving charities

Source: OECD 2008

approaches to mitigating risk of abuse (see *Regulation of the non-profit sector*). A 2010 survey of 291 NPOs on organisational risk management practices, however, found that 41 percent of respondents did not have a documented risk management policy, or were not aware if one existed for their organisation (PPB 2010). When assessing risk, 58 percent of respondents stated that their organisation factored in risk related to fraud and 46 percent considered the financial literacy of its staff.

Also for consideration is the level of adoption of fraud prevention and whistleblowing policies by Australian NPOs. Effective fraud prevention strategies, as prescribed in the Fraud and Corruption Control standards (AS8001–2008) devised by Standards Australia as part of its Corporate Governance Standards Set, are dependent on the implementation of policies and practices that incorporate:

- regular, comprehensive assessment of fraud risks to the entity in question;
- development of a fraud management plan that describes processes of identification, analysis, evaluation, treatment, implementation, communication, monitoring and reporting;
- fraud awareness and prevention training;
- establishment of clear reporting policies and procedures; and
- instigation of whistleblowing policies and other means to protect staff who report alleged incidents of fraud.

Fraud prevention policies are commonly applied in the public and private sector but less so among NPOs. A 2010 survey of 272 Australia NPOs found that 29 percent had implemented a fraud control policy, 13 percent a fraud control plan and 26 percent had undertaken fraud risk assessments (BDO Chartered Accountants and Advisors 2010). Similarly, just 40 percent of 1,123 UK charities surveyed as part of a study on fraud in the UK charitable sector reported having implemented one or more fraud prevention policies or practices (Fraud Advisory Panel 2009; the list included anti-fraud policy, anti-money laundering policy, whistleblowing policy, fidelity or crime protection insurance fraud awareness training programs, fraud response plan and a risk register). Those charities that were more likely to have some form of fraud prevention procedure in place were larger organisations and those that had experienced fraud in the past.

Whistleblowing policies are even less commonly taken up. Ideally, whistleblowing policies should aim not just to protect the identity of individuals who disclose information about perceived wrongdoings and to protect them from retribution but prescribe disclosure regimens which enable 'thorough, timely and independent investigation of concerns and have adequate enforcement and follow-up' (Transparency International 2009: np). Several jurisdictions in Australia have enacted stand-alone whistleblowing legislation, although these laws primarily provide protection for the public sector; private sector organisations have needed to develop their own 'in-house' protocols. It has been estimated that just under half of public and private sector agencies in Australia have implemented whistleblower policies or have established whistleblower services. Among NPOs, just 13 percent reported having a whistleblower policy and three percent a whistleblower service (BDO Chartered Accountants and Advisors 2010). This compares with the finding from the same survey that almost a fifth (18%) of fraud discoveries came from an employee tip-off and another 17 percent from tip-offs from other sources, including volunteers (5%) and anonymous tips (5%).

Typologies

The number of available typologies regarding the criminal misuse of NPOs is relatively small but with a few exceptions, exclusively involved charities that had either raised or concealed the transfer of funds to support terrorist activities (APG 2009, 2008, 2005, 2004; AUSTRAC 2008b; FATF 2008a, 2004b, 2003b; see Table 3). Gurulé (2008) has suggested a generalised *modus operandi* that has been adopted by US-based (Islamic) charities found to have been siphoning funds to support terrorism, that is, the entity:

- incorporates under state law;
- applies for tax-exempt status as a charity or NPO;
- fundraises through personal correspondence, newsletters and via the organisation's website;
- opens domestic bank account(s) into which

proceeds and donations are deposited; and

- transfers funds to overseas branches, diverting some (or all) of these funds for terrorist activities.

In countries where at least some regulation of the non-profit sector exists, corrupted NPOs often gained charitable or tax exempt status and registered the entity with the appropriate authority. Misuse came in the form of exploitation of legitimate charities, where funds raised for charitable purposes were diverted to individuals or groups associated with terrorism, or more commonly, in the establishment of sham charities (APG 2009, 2008, 2005, 2004; AUSTRAC 2008b; FATF 2008a, 2004b, 2003b). In a number of cases, the NPO collected funds that were disbursed with the intention of providing humanitarian or welfare relief, but a percentage was knowingly diverted to finance militant groups.

Table 3 Selected typologies of non-profit organisation misuse

Exploitation of a 'legitimate' charity
Individual A attempted to deposit large amounts of cash into the account of a charity, with a direction that the cash be forwarded to a notary as an advance for purchasing real estate. An examination of financial transactions associated with the account revealed that payments into the account comprised both multiple cash deposits (which were assumed to be donations) and transfer of funds from Individual A's personal account. Individual A's personal account had also received multiple cash deposits which authorities determined to be donations from private individuals. Cash debited from the account was transferred to the charity or sent to Individual B who was based in another country. The investigation concluded that Individual A had links with persons (including Individual B) known to be associated with terrorist activity and that the charity had been used as a front to raise and transfer funds to Individual A's associates
Establishment of a sham charity
An NPO was suspected of collating and distributing financial resources for a terrorist group based in another country. Over the course of five years, the NPO was found to have organised a substantial number of electronic funds transfers to overseas-based persons and entities, including another NPO thought to be a front for a terrorist organisation. During the same period, large sums of cash were deposited into, and multiple credits made to, the NPO's accounts. The source of these funds was unknown, as was the identity of the remitter for the credits. The deposit of cash into the NPO's accounts was frequently followed by the purchase of bank drafts or the transfer of funds overseas
Charity embedded in terrorist finance laundering network—1
Credit institutions generated suspicious transaction reports following the discovery of a discrepancy between the stated objectives of a charity (which had a poor compliance record for financial reporting) and their expenditure statements. Funds collated by the charity were found to have been transferred to a number of fictitious or shell companies before being withdrawn as cash for delivery to armed militants
Charity embedded in terrorist finance laundering network—2
A 'small' company was found to have received 'significant' number of cash deposits from a number of charities (purportedly for consultancy services rendered) and two separate individuals, both of whom were resident in regions where militant activity was entrenched. One of the two individuals received amounts of cash from an unknown source(s) that were below the reporting threshold before transferring accumulated funds in bulk to the company. The funds collected in the company's account were then being transferred to a charity operating in the North Caucusus. Some of the cash was distributed to apparently legitimate charities working in the North Caucusus but other funds were directly transferred to a 'welfare unit' that was part of a recognised militant group. The latter was subsequently shut down by authorities
Use of charity to facilitate tax evasion
A family, who operated a number of successful businesses that were being used for criminal purposes, founded a charity with the purported objective of providing for members of the religious community the family were part of. The charity was registered with the Charity Commission and provided annual statement accounts to the regulator showing receipts of less than £10,000. Intelligence revealed that the family were using the charity to launder the proceeds of their tax evasion, which was then being used to fund their lifestyles. More than £2.5m was found in the bank accounts of the charity and family members acting as the charity's trustees. The scheme was managed by the family operating multiple cash tills in each of the businesses but only declaring the income from one. Complicit family members were charged with cheating the public revenue with a confiscation order of around £5m plus £50,000 in costs

Source: FATF 2008a; FINTRAC 2009; OECD 2008

Many of the implicated charities formed part of a complex financing network, involving the movement of funds between multiple accounts held by charities, other NPOs, companies (both legitimate and fictitious) and individuals (APG 2009, 2008, 2005, 2004; AUSTRAC 2008b; FATF 2008a, 2004b, 2003b). Multiple conduits were used in the country the funds were first raised in, and to transfer funds across different jurisdictions, before eventually being transmitted to the intended recipient(s). In such cases, funds were first deposited into the bank accounts of charities, or of individuals associated with the charity, before being transferred using cash deposits, wire transfers and remittance schemes. The deposit of large amounts of cash and/or the frequency of these deposits often served as flags from which financial institutions or regulators identified potential criminal behaviour (FATF 2008a, 2004b, 2003b).

Australia

AUSTRAC (2010a: 8) lists 'financial contributions through formal charitable donations' as one of the three most common methods by which terrorism funds are raised in Australia. There are few published examples, however, of the misuse of Australian NPOs for this purpose, or in connection with money laundering activities, precluding any comment on trends in misuse. Two cases reported by AUSTRAC are briefly described in Table 4.

It was reported in the 2010 typology report from the Asia-Pacific Group on Money Laundering that the most 'significant' cases of non-profit abuse for terrorism financing detected in Australia involved the collection of donations, often following a visit by an overseas speaker that was organised by local leaders (APG 2010). In these cases, the funds raised were wire transferred to overseas accounts but usually over a period of time in amounts of less than $10,000. These funds were generally sent to third parties who were suspected of having a connection with a terrorist organisation.

Some reports of NPO misuse have arisen in the Australian media. At least three NPOs have been identified by the media as having alleged links with known terrorist organisations ('Claim money from Aust sent to organisations linked to terrorism' *The 7.30 Report* 24 June 2003; Kerbaj 2008a, 2008b, 2007; Welch 2008). One charity was linked with both KOMPAK (an Indonesian charity thought to be associated with Jemaah Islamiyah) and Interpal, a proscribed organisation in Australia and the United States (see below for UK investigation of Interpal). The charity was reported to have raised $10,000 for KOMPAK in 2000 (to provide for an earthquake appeal) but stated that only half of that money was actually sent because KOMPAK had not delivered a report detailing how the first instalment of funds had been used ('Claim money from Aust sent to organisations linked to terrorism' *The 7.30 Report*

Table 4 Published case studies of misuse of Australian non-profit organisations

Case study 1
A large number of international fund transfer instructions were being issued to various overseas-based businesses alleged to be acting as fronts for an 'identified' terrorist organisation. It was determined that most of these funds were being raised from private, charitable donations and cash generated from legitimate businesses (eg groceries, restaurants and other hospitality establishments). The business-generated funds were funnelled to the 'charity' via real estate investments, bank deposits and person-to-person transfers
Direct debit was used to transfer the 'charitable funds' into a central bank account (which was being supplemented by funds via cash cheques and credit cards). These funds were then transferred using wire transfers to international bank accounts held by the front companies and distributed to different accounts within Australia using bank-to-bank transfers. Many of the wire transfers were for amounts under the $10,000 reporting threshold
Case study 2
A church fund was used to launder assets as part of a scheme to defraud a private company. The money originated from a company in which one of the complicit parties was employed and who held responsibility for the management of the company's financial affairs. The funds were transferred from the company's accounts through a series of private and third-party accounts; some of the funds were transferred internationally before being returned, via wire transfer, into a trust account held by the second complicit party. Around $350,000 was drawn from the trust account and transferred to a church fund. At the time of detection, the second complicit party was planning to move the church fund monies to overseas-based accounts

Source: AUSTRAC 2010a, 2008a

24 June 2003). In 2008, the same charity became the subject of another investigation, from the Australian Council for International Development (ACFID) and the NSW Office for Liquor, Gambling and Racing, after it was discovered it had advertised on its website an Interpal fundraising appeal (Kerbaj 2008a). Its offices were raided by the Australian Federal Police and NSW Police in July 2008 and computer files and financial records were seized (Kerbaj 2008b). An Australian Federal Police investigation was also launched against another Australian NPO when it was found unable to account for some of the $70,000 it had raised with other charities to support victims of the Israeli-Hezbollah war in Lebanon (Welch 2008). There is no publicly available information regarding the outcome for either of these NPOs, although the retention of the former on ACFID's list of current members (who are signatories to their code of conduct) suggests no further action was needed or taken.

Aruran Vinayagamoorthy, Sivarajah Yathavan and Armugan Rajeevan

In December 2009, Aruran Vinayagamoorthy, Sivarajah Yathavan and Arumugan Rajeevan pleaded guilty to offences under the *Charter of the United Nations Act 1945* (Cth) for making assets (either directly or indirectly) available to an entity (the LTTE) proscribed for the purposes of that Act. It was the prosecution's case that the defendants, as members of the Tamil Coordinating Committee, had played a role in the collection and transfer of $1,030,259 in donations to the LTTE between the 13 December 2002 and 12 October 2004. Mr Vinayagamoorthy had also been indicted for making an estimated $97,000 worth of electronic components available to the LTTE over a period of about two years.

At sentencing, Justice Coghlan noted that it was more than probable the defendants were aware that the LTTE not only had been declared a terrorist organisation but also that it had been formally designated as such in other countries. He stated that the 'complex structuring...used to transmit (the) funds' implied the defendants understood the LTTE to be a proscribed entity (Transcript of proceedings, *R v Vinayagamoorthy & Ors*, Supreme Court of Victoria, Coghlan J, 31 Mar 2010: 13). While it was not possible to say precisely how much money was eventually made available to the LTTE, Justice Coghlan considered that they were large amounts (no less than $700,000). However, the court accepted that the defendants were motivated partly by a desire to assist the Tamil community and the funds were 'not purposely (collected) to assist terrorist activity (Transcript of proceedings, *R v Vinayagamoorthy & Ors*, Supreme Court of Victoria, Coghlan J, 31 Mar 2010: 31).

Yathavan and Rajeevan were each sentenced to a term of imprisonment of one year, but released on three year good behaviour bonds. Vinayagamoorthy was sentenced to an effective term of two years, but released on a four year good behaviour bond (*R v Vinayagamoorthy & Ors* [2010] VSC 148, 31 March 2010).

Nachum Goldberg

The Goldberg case differs from all but one of the cases presented in this section in that it did not involve an alleged misuse of an NPO to support terrorism. Instead, it represents how a fictitious charity was nominated to enable money to be laundered out of Australia. Between 1990 and 1997, Nachum Goldberg and members of his immediate family operated a money laundering scheme through which at least $48m was transferred from Australia to Israel. The scheme centred on the use of an internal bank management account that was opened in the name of United Charity, to give the appearance the deposited money was being used for genuine charitable purposes (CDPP 2001). The charity did not legally exist nor had it been registered as either a charity or company. Funds from the account were transferred to four banks in Jerusalem and Tel Aviv, one of which was managed by Goldberg's brother.

The money that was being laundered was the cash proceeds from Australian business activity that had not been disclosed to the ATO (CDPP 2001). The original manifestation of the scheme simply involved Goldberg and his family making regular cash deposits into the account. Many of these deposits consisted of considerable sums of money—up to 154 deposits were of at least $100,000 and 12 deposits of $200,000 (CDPP 2001). The scheme subsequently evolved into using 'bogus' cheques, whereby complicit businessmen wrote cheques for

Jewish 'charities' that were then purchased for cash. The enterprise allowed the businessmen to claim a tax deduction on what was perceived to be a charitable donation and Goldberg to bolster the appearance the account was being used to hold and transfer funds for charitable relief (*DPP (Cth) v Goldberg* [2001] VCSA 107; (2001) 184 ALR 387).

One of the primary factors that assisted Goldberg from initially escaping suspicion was the type of account (an internal bank management account) he used to transfer the money. This type of account would have been unlikely to attract official scrutiny from regulators, despite the vast amounts of cash that were deposited each week, as they are generally used for normal inter- or intra-bank commercial transactions and the names of account holders are not listed with AUSTRAC (*DPP (Cth) v Goldberg* [2001] VCSA 107; (2001) 184 ALR 387). According to one of the appeal judges, the use of such a bank account was 'unlikely to have been unintended' and suggested that Goldberg had extensive knowledge of bank procedures, some degree of cooperation from within the bank and a level of comprehension of AUSTRAC processes and operations (Transcript of proceedings, *DPP (Cth) v Goldberg*, Supreme Court of Victoria—Court of Appeal, Vincent JA, 27 Jul 2001: 20). The laundering was only detected in 1995 with the appointment of a new manager at the branch who removed the United Charity's manager account status. This opened the account to AUSTRAC scrutiny, who for the first time became aware of the large number of transactions associated with the account and began investigations.

Goldberg, his wife and one of his sons pleaded guilty on 14 March 2000 to one count of conspiring to defraud the Commonwealth (between 1 January 1990 and 14 September 1995), contrary to s 86A of the *Crimes Act 1914* (Cth) and one count of conspiring to defraud the Commonwealth (between 15 September 1995 and 19 June 1997), contrary to s 86 of the same Act. His other son pleaded guilty to the first count. As the principal actor in the operation, Goldberg was originally sentenced in June 2000 to an effective term of five years imprisonment and directed to, with the other defendants, to make reparations to the Commonwealth of $15m. The Commonwealth Director of Public Prosecutions (CDPP) appealed the leniency of the sentence to the Victorian Court of Criminal Appeal, which upheld the appeal and sentenced Goldberg to seven years imprisonment, with a non-parole period of four and a half years (*DPP (C'th) v Goldberg* [2001] VCSA 107; (2001) 184 ALR 387).

United Kingdom

Cases of UK-registered NPOs suspected of supporting terrorism have invariably involved investigation by the Charity Commission. Between 1 July 2008 and 30 June 2010 the Commission completed 18 inquiries into charities where there were allegations of links to terrorism (Charity Commission 2010a, 2009b). In most cases, the charity was examined because of the actions of a trustee, or the trustees' suspected association with a known terrorist group. Where the outcome of the inquiry was documented, trustees of concern were removed and directions given regarding improvements to governance and financial reporting arrangements (Charity Commission 2010a, 2010b, 2010c, 2010d, 2009b, 2008a).

Significant action, such as freezing a charity's assets, or de-registering or shutting down the charity, has been relatively uncommon. In 2006, for example, the charity *Crescent Relief* had its assets (temporarily) frozen after media reports suggested that persons involved in an alleged plot to bring down transatlantic passenger aircraft were connected to the charity (Kennedy, O'Shea & Devlin 2006). Another case involved the charity *Iqra*, which was registered with the Charity Commission in 2003 but had never submitted obligatory annual financial accounts (Jump 2009). Two of the charity's former trustees—Mohammed Sidique Khan and Shehzad Tanweer—were involved in the 7 July London terrorist attacks. The Commission launched a statutory inquiry into the charity in May 2009, following the acquittal of another of the charity's trustees of involvement in the July attacks. Both investigations appear to be continuing.

Interpal (or the Palestinians Relief and Development Fund) represents an interesting case as the UK's response to this charity has differed to that of the US (Sidel 2010). Interpal, designated by the US Government as a terrorist organisation, was investigated three times by the Charity Commission on suspicion of providing funds to Hamas for use in

militant activities, but each inquiry found no evidence for the allegation. In its final inquiry, the Commission stated that Interpal had maintained appropriate audit trails in its delivery of financial aid but recommended the charity engage in improved due diligence and monitoring activities with respect to partner organisations (Charity Commission 2009b).

Tamils Rehabilitation Organisation

The Tamils Rehabilitation Organisation (TRO) was a London-based charity that was investigated by the Charity Commission for diverting funds, via TRO Sri Lanka, to LTTE. LTTE is a proscribed organisation under the UK's *Terrorism Act 2000*. It was alleged that the TRO, and three other charities, were being used by the LTTE for fundraising and propaganda purposes and their registration as a charity in the United Kingdom had enabled them to move funds to Sri Lanka without paying tax (Charity Commission 2005).

When the TRO refused to comply with a request to provide financial information, the Commission enacted s 18 of the *Charities Act 1993* to restrict transfer of funds out of the charities' accounts. Documents seized from a raid on the TRO's offices revealed inadequate financial controls, lack of operational transparency and evidence of mismanagement (Sidel 2010). Of particular concern was the finding that the TRO's trustees could not account for the use of funds transferred to Sri Lanka, nor the origin of funds sent to the London agency from chapters based in the United States and Canada (Charity Commission 2005).

The Charity Commission removed the TRO's trustees and brought in an interim manager to oversee the charity and assist in ascertaining whether the charity could still fulfil its objective of providing charitable relief and observe its legal obligations (Charity Commission 2005). Evidence that TRO Sri Lanka had mediated with LTTE regarding the distribution of funds suggested it could not and a new charity (the Tamil Support Foundation) was formed in its place to absorb the remaining TRO-held funds. In the end, the funds were sent to the Indian Ocean tsunami appeal, and TRO was subsequently deregistered and ceased to exist as an operating entity.

North London Central Mosque

The case involving the North London Central Mosque (or Finsbury Park Mosque) departs from other examples of charity misuse in that the ensuing investigation(s) were not initiated because of evidence for misappropriation of funds (collected by the mosque's *zakat* committee) but due to public statements, considered to be of 'an extreme and political' nature (Charity Commission 2003, in Sidel 2010: 166), made by the mosque's imam, Abu Hamza. The inference was that the mosque's trustees, of which Hamza was one, were fomenting terrorist sympathies and encouraging terrorist engagement (Sidel 2010).

In April 2002, the Charity Commission, which can act if it considers a charity is being used for political purposes, stipulated that Hamza be suspended from his role as one of the mosque's trustees. Following Hamza's refusal to relinquish the position, the Commission acted to freeze all accounts linked to Hamza, closed down certain activities run by the mosque, and in February 2003, Hamza was permanently excluded from all positions he had held at the mosque (Dodd 2003). A new board of trustees was also established to remove any individuals still sympathetic to Hamza.

United States

The largest number, and arguably the more high-profile cases of NPO exploitation by terrorist groups, come from the United States. In its 2006 update of the anti-terrorist financing guidelines, the Department of Treasury stated that the charities and individuals so far designated on the Specially Designated Nationals (SDN) list represented

> fifteen percent of all US-designated terrorist supporters or financiers, indicating the primary importance of charities as a critical means of support for terrorist organizations and activities (US Department of the Treasury 2006a: 15).

The SDN List classifies prescribed organisations and individuals that US citizens are prohibited from dealing with (see *Regulation of the non-profit sector*).

The US legal and policy response to terrorism financing has 'favored a prosecution-driven approach, often based on strict or negligence liability

as opposed to specific intent' (Sidel 2010: 185). Between November 2001 and March 2008, there were 76 cases where action was taken against individuals associated with charities and 18 cases against the charity (The Center on Law and Security 2008). Of these, 26 involved charges in relation to one or more of the four terrorism statutes, including 17 USC 2339A (*Material Support to Terrorists*), 18 USC 2339B (*Material Support to a Terrorist Organization*) and 50 USC 1705 (*Financial Support to a Foreign Terrorist Organization*). The majority of cases prosecuted or currently being heard in the United States involve(d) al Qaeda- or Hamas-related charitable fundraising.

Benevolence International Foundation

The Benevolence International Foundation USA (BIF-USA) was an Illinois-based tax-exempt NPO that conducted humanitarian relief projects in countries and regions such as Bosnia, Pakistan, Central Asia and the Caucusus. The US office formed part of a trio of incorporated entities—the other two were based in Canada and Bosnia—which collectively oversaw a network of branch offices. According to Internal Revenue Service (IRS) tax returns, the charity had raised in excess of US$15m between 1995 and 2000, although the Federal Bureau of Investigation estimated its takings were much higher, averaging US$40,000–60,000 dollars a week (Roth, Greenberg & Wille 2004).

Enaam Arnaout, the executive officer of BIF-USA, was considered by the US Government as having jihadist sympathies and connections with Osama bin Laden. Raids on BIF-USA's Bosnian and US offices found copies of correspondence between Arnaout and bin Laden which, along with intelligence indicating that BIF-USA had undertaken financial transactions for al Qaeda, was used as substantiation to freeze BIF-USA's accounts (in December 2001). The charity was designated in November 2002 (Roth, Greenberg & Wille 2004). Enaam Arnaout was subsequently charged with racketeering, conspiracy to provide and actual provision of material support to terrorists, money laundering and wire and mail fraud. In August 2003, Arnaout pleaded guilty to fraudulently obtaining charitable donations and using them to provide financial assistance to individuals engaged in violence and was sentenced to 11 years in federal prison.

Global Relief Foundation

The Global Relief Foundation (GRF) also operated as a tax-exempt NPO in Illinois. Its mission was to provide humanitarian and charitable relief to Muslim peoples living in conflict zones. The GRF was equally successful in raising considerable sums of money (around US$5m in 1991) through donations, of which a significant percentage (up to 90%) was sent overseas (Roth, Greenberg & Wille 2004).

The US Government long believed the GRF was affiliated with terrorism but were unable to establish the ultimate destination of transferred funds. However, intelligence revealed that the GRF had provided and received funding from individuals associated with al Qaeda, received funds from another designated charity, the Holy Land Foundation for Relief and Development (HLF; see below), distributed material that championed 'martyrdom through jihad' and requested donations to supply the mujahedeen with ammunition, food and transport (Roth, Greenberg & Wille 2004; US Department of the Treasury 2002). GRF's assets were frozen in December 2001 and it was designated by the Department of Treasury in October 2002.

Unlike the two previous cases, no criminal charges were ever filed against GRF or its associates. Rabih Haddad, the chairman of the GRF, was arrested the same day GRF's assets were frozen and after 18 months in detention, was deported to his birth country of Lebanon for a visa irregularity (Swarns 2003). Haddad had applied for political asylum in the United States the previous year but was found ineligible due to being found a risk to national security (Comstock 2002).

Holy Land Foundation for Relief and Development

Founded in California in 1989 before moving its offices to Texas, HLF was the largest Muslim charity in the United States, established to provide humanitarian assistance to Palestinians living in Gaza and the West Bank. HLF was shut down, had its assets frozen and designated an SDN in December 2001 after it was alleged that the charity provided financial support to Hamas through the transfer of funds to HLF offices in the West Bank and Gaza and *zakat* committees controlled by Hamas (US Department of the Treasury 2001).

HLF and its officers—Shukri Abu Baker (Secretary and Chief Executive Officer), Mohammed El-Mezain (Director of Endowments), Ghassan Elashi (Chairman of the Board), Haitham Maghawri (Executive Director), Akram Mishal (Projects and Grants Director), Mufid Abdulqater (fundraiser) and Abdulraham Odeh (HLF New Jersey representative)—were first indicted in July 2004, accused of funnelling US$12.4m to individuals and groups linked to Hamas (US Department of Justice 2004). It was alleged that some of this money was used by Hamas to support suicide bombers and their families. Charges listed in the indictment included money laundering and conspiracy to provide and actual provision of material support to a foreign terrorist organisation. The jury in the first trial were unable to reach a unanimous decision on most counts against the accused and the judge declared a mistrial.

In the subsequent trial, however, a federal jury convicted HLF and five of the defendants of all conspiracy charges. HLF and two of its founders (Shukri Abu Baker and Ghassan Elashi) were additionally convicted on the substantive charges related to the provision of material support and resources to a foreign terrorist organisation, provision of funds, goods and services to an SDN, and money laundering (US Department of Justice 2008a). On 27 May 2009, the convicted received sentences ranging from 15 to 65 years imprisonment (US Department of Justice 2009).

Islamic American Relief Agency

The Islamic American Relief Agency (IARA) was the US-based branch of the Sudanese-founded Islamic Africa Relief Agency. IARA was incorporated in 1985 under Missouri law as a tax-exempt charity and sought donations from Muslim expatriates living in the United States to provide humanitarian relief and fund development projects. The charity was known to have raised between $1–3m each year between 1991 and 2003.

The IARA network was designated by the US Department of Treasury in October 2004 for providing direct financial support to Maktab Al-Khidamat (the precursor to al Qaeda) and Osama bin Laden, as well as to Hamas (US Department of the Treasury 2004). The US-branch of IARA tried twice to have it assets reinstated but the Federal Court and the US Court of Appeals both held that the charity's claims were without merit and dismissed the case.

In January 2008, a federal grand jury returned a 42 count superseding indictment that charged IARA, five of its officers and associates, and a former US congressmen, with the illegal transfer of funds to Iraq, terrorist financing, money laundering, theft of federal funds and obstruction of federal tax laws (US Department of Justice 2008b). Among the charges, IARA and some of its officers—Mubarek Hamed (former director), Ali Mohamed Bagegni (former member of IARA's board of directors), Ahmad Mustafa (former fund-raiser) and Khalid Al-Sudanee (regional director of Middle East office)—were alleged to have laundered funds in excess of US$1.4m to Iraq, in violation of the *International Emergency Economic Powers Act* (IEEA) and the Iraqi Sanctions Regulations. The funds, which were raised from donations to support individuals and organisations based in Iraq, were deposited in bank accounts in Jordan held by IARA.

Mubarek Hamed pleaded guilty in June 2010 to conspiracy to violate the IEEA (18 USC s 371), one count of violating the IEEA (50 USC ss 1701–1706) and one count of obstructing administration of internal revenue laws (Phillips 2010a). These counts related to Hamed illegally wiring funds, with the assistance of an SDN-listed person living in Jordan, of almost US$500,000 to IARA bank accounts in Jordan (Phillips 2010a). Hamed's co-defendant Mustafa pleaded guilty in December 2009 to illegally transferring funds to Iraq in violation of IEEA (Whitworth 2009) and Bagegni pleaded guilty in April 2010 to conspiracy to violate the IEEA (Phillips 2010b).

Inadvertent support of terrorism through donation to charities

The US case of *Boim v Holy Land Foundation for Relief and Development et al. 2008* considered whether persons or charities with a known or suspected association with a proscribed group can be found legally responsible for a criminal or terrorist act committed by this group. In this case, three US-based NPOs, which were known to have

raised funds for Hamas, an SDN-listed group, were found liable for the death of David Boim, a US citizen who was killed in Israel by two alleged Hamas militants. In the leading judgement from the original finding, Judge Posner noted that

> Hamas is...engaged not only in terrorism but also in providing health, educational and other social welfare services. The defendants...directed their support exclusively to those services (Transcript of proceedings, *Boim v Holy Land Foundation for Relief and Development et al. 2008*, US 7th Circuit Court of Appeals (Chicago), Posner R, 3 Dec 2008: 36).

However, he noted in addition that

> ...if you give money to an organization that you know to be engaged in terrorism, the fact that you earmark it for the organization's non-terrorist activities does not get off the liability hook (Transcript of proceedings, *Boim v Holy Land Foundation for Relief and Development et al. 2008*, US 7th Circuit Court of Appeals (Chicago), Posner R, 3 December 2008: 36).

In a dissenting judgement, Judge Rovner noted that

> the majority's approach treats all financial support provided to a terrorist organization and its affiliates as support for terrorism, regardless of whether the money is given to the terrorist organization itself, to a charitable entity controlled by that organization, or to an intermediary organization, and regardless of what the money is actually used to do (Transcript of proceedings, *Boim v Holy Land Foundation for Relief and Development et al. 2008*, US 7th Circuit Court of Appeals (Chicago), Rover I, 3 Dec 2008: 60).

An *en banc* review had previously argued that the requirement to prove causation was relaxed in cases involving terrorist organisations. Liability, however, was reinstated with Judge Posner reiterating that irrespective of the defendant's alleged charitable intentions, donating money to an entity that is known to commit terrorist act supposes that 'one knows there is substantial probability that the organization engages in terrorism but one does not care' (Transcript of proceedings, *Boim v Holy Land Foundation for Relief and Development et al. 2008*, US 7th Circuit Court of Appeals (Chicago), Posner R, 3 Dec 2008: 20).

The ruling in this case arguably renders it difficult to donate to an NPO's humanitarian endeavours without fear of prosecution should that NPO also support the terrorist endeavours of the same organisation. To a degree, it would seem difficult in practice to make the crucial distinction in terms of funding decisions.

Conclusion

The typologies and case studies reproduced here show that known cases of non-profit exploitation mostly came in the form of:

- establishing a sham charity, often registered and acting according to regulatory requirements but primarily engaged in laundering or collecting funds for illicit or terrorist purposes; or
- administering an ostensibly legitimate charity that delivered funds to a sister organisation which provided humanitarian relief but also engaged in criminal or terrorist activities.

It was difficult to identify from the detail given in the available typologies and case studies the dominant method(s) by which the funds were transferred and to what extent the schemes depended on formal versus informal modes of funds transfer. It was clear, though, that most schemes had used a complex system of accounts held by different individuals or entities, and based in multiple jurisdictions, to funnel and hence obscure funds transactions.

The pattern, albeit based on a handful of cases, indicates that the abuse of NPOs is predominantly for the purpose of financing terrorism rather than for laundering funds. It is unclear whether this pattern reflects reality or political focus. What is evident from these case studies is that legitimate NPOs are apparently not the target of misuse. This is not to say that *involuntary* misuse does not occur since fraud, which is outside this scope's report, is almost certainly being committed at times without the complicity of the organisation and is probably facilitated by inadequate financial oversight. However, in most detected cases of money laundering and terrorism financing, collusion has generally existed among persons controlling the NPO, who chose to create an organisation to suit their purposes rather than infiltrate and corrupt an existing entity.

Sector surveys have shown that NPOs need to do more to improve their financial management and controls, and to increase their uptake of risk management strategies. Without these in place, the risk of misuse is markedly greater. The non-profit sector has argued that there is no evidence for sustained money laundering/terrorism financing-related misuse having occurred because of a lack of financial oversight. The available evidence *suggests* this is so but its limited nature excludes any firmer inference.

With respect to terrorism financing, the greatest risk for legitimate charities appears to be what happens to funds once outside the organisation's immediate administrative jurisdiction. Due diligence and similar measures are promoted as curtailing this risk but even among organisations that have the capacity to invest in such measures, circumstances sometimes mean these guards have to be dropped.

Regulation of the non-profit sector

The substantial number and variation of organisations within the non-profit sector has necessitated or resulted in an historical and relatively high degree of self-regulation and, depending upon the jurisdiction concerned, with or without external oversight. Compared with for-profit entities who are obliged to produce financial reports compliant with international financial reporting standards, non-profits are exposed to 'minimal' regulation and 'under-developed' financial reporting requirements (Cordery & Baskerville 2007).

Nonetheless, there are already instances of recognised good practice in the regulation and monitoring of the non-profit sector in individual states. In more recent years, conventional regulatory supervision has been combined with a range of mitigation strategies developed specifically to cope with threats related to money laundering and terrorism financing. This 'acceleration' in the development of such tools is, according to Weber (2008: 24):

> the most significant and far-reaching outcome of the discussion on the relationship between [non-profit] institutions, terrorism, and its financial networks...In the framework of the war on terrorism, the political need to regulate non-profit organizations reinforces whoever for a long time has stressed the lack of transparency and accountability of the sector.

This section first describes and contrasts the regulatory regimes for NPOs operating in Australia, the United Kingdom, the United States, Canada and New Zealand. All employ a mix of government and statutory oversight in conjunction with sector self-regulation. Charities tend to be the focus of regulatory control but scope varies between jurisdictions, as does the reporting requirements NPOs must comply with. The second part of the section summarises selected mitigation strategies developed for use by regulators and/or NPOs that aim to educate the sector on specific risks, recommend changes to governance and financial transparency procedures to minimise risk and provide regulators with guidelines in how to respond to suspicion of misuse.

Regulation in Australia

The current regulatory framework for the non-profit sector in Australia has been described as 'unnecessarily complex, confused and costly' (Productivity Commission 2010: 114), despite numerous reviews undertaken to examine options for streamlining the regime and legislative changes made to simplify processes. Central to this complexity are the different legal forms, reporting obligations, fundraising requirements and tax

arrangements open to NPOs. These factors, combined with a lack of standardisation of laws across jurisdictions, have instituted a system that imposes a considerable compliance burden on NPOs without promoting the level of transparency and accountability that is important for a sector reliant on the confidence and trust of its stakeholders.

Legal forms

The majority of NPOs operating in Australia are unincorporated, in that they do not have a formal legal form that distinguishes them from their members (Productivity Commission 2010; see Table 5). NPOs that do have formal legal status are mostly associations incorporated under state and territory

Table 5 Number of non-profit organisations by legal form

Legal form	Number
Companies limited by guarantee	11,700
Incorporated associations (under state and territory legislation)	136,000
Cooperatives	1,850
Incorporated by other methods	9,000
Unincorporated	440,000
Total	598,550

Source: Adapted from Box 4.1, Productivity Commission 2010

Table 6 Incorporated association legislation and primary regulators

Jurisdiction	Act	Regulator
Cth	*Corporations Act 2001*	Australian Securities and Investment Commission
	Corporations (Aboriginal and Torres Strait Islander) Act 2006	
NSW	*Associations Incorporation Act 1984 No 143* [a]	Office of Fair Trading
	Associations Incorporation Act 2009 [a]	
	Co-operatives Act 1992	
Vic	*Associations Incorporation Act 1981*	Consumer Affairs Victoria
	Co-operatives Act 1996	
Qld	*Associations Incorporation Act 1981* (as amended by the *Associations Incorporation and Other Legislation Amendment Act 2007*)	Office of Fair Trading
	Cooperatives Act 1997	
WA	*Associations Incorporation Act 1987*	Department of Commerce
	Companies (Co-operative Act) 1943	
	Co-operative and Provident Societies Act 1903	
SA	*Associations Incorporation Act 1985*	Office of Consumer and Business Affairs
	Co-operatives Act 1997	
Tas	*Associations Incorporation Act 1964*	Consumer Affairs and Fair Trading
	Cooperatives Act 1999	
ACT	*Associations Incorporations Act 1991*	Office of Regulatory Services
NT	*Associations Act*	Business Affairs and Agents Licensing (Department of Justice)

a: The *Associations Incorporation Act 2009* succeeded the *Associations Incorporation Act 1984* in 2010

legislation or public companies limited by guarantee and registered under the *Corporations Act 2001* (Cth). In addition to these are a smaller but diverse group of legally formalised entities, including cooperatives, charitable trusts, religious associations, Aboriginal corporations and organisations that have been established under Royal Charter or a special Act of Parliament (Productivity Commission 2010).

Organisations that remain unincorporated are relieved of regulatory oversight, including the reporting requirements that come with incorporation. Incorporation, however, delivers benefits such as perpetual succession, a means to enter enforceable contracts and limited liability for members (ACG 2005; Productivity Commission 2010). Table 6 lists legislation relevant to incorporated entities, including co-operatives.

Organisations incorporated under state or territory law can only trade in that jurisdiction and thus, NPOs operating across state/territory borders must incorporate the organisation in every state they operate in. Apart from the inconvenience of having to register more than once are legislative inconsistencies around eligibility and disclosure requirements. This problem can be alleviated by migrating to a company limited by guarantee. However, incorporation under the *Corporations Act 2001* (Cth) is accompanied by increased costs and greater administrative demands, and requires observance of laws that are not always applicable to the nature and undertakings of non-profit entities (ACG 2005; Productivity Commission 2010).

Fundraising

Some form of authority (usually in the form of a licence) is required in all states and territories, except the Northern Territory, if an NPO engages in the solicitation or receipt of money, goods or property for 'charitable purposes'. Fundraising laws are prescribed in separate 'charitable collection' and 'gaming' legislation (see Table 7). The former regulates 'conventional' fundraising activities and

Table 7 Fundraising and gaming legislation and regulators

Jurisdiction	Act	Regulator
NSW	*Charitable Fundraising Act 1991*	Office of Liquor, Gaming and Racing
	Lotteries and Art Unions Act 1901	
Vic	*Fundraising Appeals Act 1998*	Consumer Affairs
	Gambling Regulation Act 2003	Victorian Commission for Gambling Regulation
Qld	*Collections Act 1966*	Office of Fair Trading
	Charitable and Non-Profit Gaming Act 1999	Office of Gaming Regulation
WA	*Charitable Collections Act 1946*	Department of Commerce
	Gaming and Wagering Commission Act 1987	Office of Racing, Gaming and Liquor
SA	*Collections for Charitable Purposes Act 1939*	Office of Liquor and Gambling Commissioner
	Collection for Charitable Purposes Act 1939—Code of Practice	
	Lottery and Gaming Act 1936	
Tas	*Collections for Charities Act 2001*	Consumer Affairs and Fair Trading
	Gaming Control Act 1993	Tasmanian Gaming Commission
ACT	*Charitable Collections Act 2003*	Office of Regulatory Services
	Lotteries Act 1964	ACT Gambling and Racing Commission
NT	*Gaming Control Act*	Racing, Gaming and Licensing Division, Department of Justice

the latter covers activities such as raffles, lotteries and bingo. What constitutes both a charitable purpose and fundraising differs between the jurisdictions, as do the rules prescribing who is eligible to conduct and participate in a fundraising appeal, how the fundraising should be carried out and the type of records that should be kept on how funds were received and allocated. NPOs must register as a charity before a fundraising authority can be issued.

Fundraising authorities are granted by the relevant state and territory regulator and while application processes vary, they generally require information on the proposed beneficiary, the legal structure of the organisation, details of the registered auditor and the organisation's financial details. Certain organisations are exempt from needing formal permission to fundraise and again, this varies between the states and territories. In New South Wales, for example, religious bodies are exempt, while in Tasmania incorporated associations do not need to obtain a licence to fundraise, unless they have been incorporated in another state. Victoria exempts NPOs that receive less than $10,000 gross from fundraising activities, do not get paid for conducting fundraising activities and/or use only unpaid volunteers.

Reporting requirements

NPOs are obligated to maintain and submit financial and other information depending on their legal structure, the stipulations associated with fundraising permissions and/or on receipt of acquittal of government funding or a government-funded service delivery contract. Among the frequently acknowledged problems with the existing regulatory regime is the absence of a 'robust framework for reporting' (ACG 2005: vi). Unincorporated associations do not need to disclose financial information, while incorporated associations and most entities engaged in fundraising often have multiple reporting requirements, with considerable duplication of effort. This is particularly valid for associations incorporated in different states.

Financial reporting requirements for incorporated associations and companies limited by guarantee

NPOs limited by guarantee are required, under the *Corporations Act 2001* (Cth), to report to Australian Securities and Investment Commission (ASIC) their financial position and all transactions that occurred in the preceding 12 month period. Entities are to prepare and lodge with ASIC documents similar to that expected of public companies—a copy of the annual financial and director's report, a balance sheet, income and expenditure (profit/loss) and cash flow statements, and accompanying notes to financial statements.

Associations incorporated under state and territory legislation are also required to submit mostly similar financial information to the state regulator (see Table 8). This requirement is waived in Western Australia unless the entity is directed to provide financial records by the Commissioner. Exemptions are available in South Australia for non-prescribed associations (ie associations with gross receipts less than $500,000) and in Tasmania for entities with total annual revenue, or total assets, of less than $40,000.

The level of auditing scrutiny stipulated also varies between jurisdictions (see Table 8). Associations incorporated under NSW law are not required to have their accounts audited, nor do non-prescribed associations incorporated in Victoria and South Australia (see Table 8 for definition of prescribed and non-prescribed associations). Organisations in Queensland with total revenue or current assets of less than $100,000 only need their financial records verified—by an accountant for a Level 2 association (ie an association with current assets or revenue of between $20,000–100,000) and the President or Treasurer for a Level 3 association (ie an association with current assets or revenue of less than $20,000). By contrast, those with total revenue or current assets exceeding $100,000 (Level 1 association) must be audited by a certified accountant or auditor. In every other case, an incorporated non-profit association in Australia must arrange to have their accounts audited, although the persons permitted to undertake the auditing generally depends on the

Table 8 Financial reporting and auditing requirements for companies limited by guarantee and incorporated associations

Jurisdiction	Association type	Financial reporting and auditing requirement
Cth	All	Lodgement of directors' report and declaration, balance sheet, profit and loss statement, cash flow statement, statement of changes in equity and notes to the financial statement *Audited by registered company auditor*
NSW	All	Lodgement of annual financial statement including statements regarding income and expenditure, assets and liabilities, mortgages, charges and other securities affecting property, and the activities of trusts controlled by the entity *No auditing required*
Vic	All	Lodgement of annual financial statement including statements regarding income and expenditure, assets and liabilities, mortgages, charges and other securities affecting property, and the activities of trusts controlled by the entity
	Prescribed Incorporated Associations (ie associations with an annual gross revenue of more than $200,000 or with assets in excess of $500,000)	*Auditing to be conducted by registered company auditor, member of the CPA or the ICAA or any other person approved by the Registrar*
	Non-prescribed Incorporated Association	*No auditing required*
Qld	All	Lodgement of annual financial statement including statements regarding income and expenditure, assets and liabilities, mortgages, charges and other securities affecting property
	Level 1 association—current assets of more than $100,000 or total revenue of more than $100,000	*Audited by certified accountant or auditor*
	Level 1 association—required to be audited under the *Collections Act 1966* and *Gaming Machine Act 1991*	*Audited by certified accountant or auditor, or person approved by Commissioner for Fair Trading*
	Level 2 association—current assets of between $20,000–100,000 and/or revenue between $20,000–100,000	*Verified by certified accountant or auditor, or person approved by Commissioner for Fair Trading*
	Level 3 association—current assets of <$20,000 and revenue of <$20,000	*Verified by President or Treasurer of entity*
WA	All	No requirement to submit annual financial statement or have accounts audited unless directed by the Commissioner
SA	Prescribed associations (ie gross receipts in excess of $500,000 or such greater amount that is prescribed by regulation)	Lodgement of annual periodic return with copy of accounts *Audited by a registered company auditor, firm of registered company auditors, member of the CPA or the ICAA, or person approved by the Commissioner*
	Non-prescribed associations	No requirement to submit annual periodic return or have accounts audited
Tas	All (unless exempt) Exempt if total annual revenue is less than $40,000, three-quarters of members voted against lodging an annual return, or total assets are less than $40,000 (not including 'real property')	Lodgement of annual return including an income and expenditure statement, a report on account record keeping and a statement verifying the adequacy of the accounts to explain financial transactions and financial position *Audited by registered company auditor or person approved by the Commissioner*

Table 8 (continued)

Jurisdiction	Association type	Financial reporting and auditing requirement
ACT	All	Lodgement of annual financial statement including statements regarding income and expenditure, assets and liabilities, mortgages, charges and other securities affecting property
	Association with revenue more than $500,000	*Audited by registered company auditor*
	Association with gross income or gross assets of more than $150,000 or more than 1000 members or holding a liquor licence	*Audited by member of the ICAA, NIA or CPA*
	Other	*Audited (but not required to be an accountant)*
NT	All	Lodgement of annual financial statement including statements regarding income and expenditure, assets and liabilities, mortgages, charges and other securities affecting property, and the activities of trusts controlled by the entity
	Tier 1 association—gross annual receipts of less than $25,000 and gross assets of less than $50,000	*Audited by non-associated lay person*
	Tier 2 association—gross annual receipts of between $25,000–250,000, gross assets of between $50,000–500,000 or holds a gaming machine licence	*Audited by a person who is a member of an accountants body or who holds a prescribed qualification*
	Tier 3 association—gross annual receipts of more than $250,000, gross assets of more than $500,000	*Audited by a person who holds a public practice certificate issued by an accounting body or a person approved by the Commissioner*

Note: CPA=Australian Society of Certified Practising Accountants, ICAA=Institute of Chartered Accountants in Australia, NIA=National Institute of Accountants

Source: Adapted from The Treasury 2007

size of the entity. The greater the assets or revenue, the more professionally trained the scrutineer must be.

Financial reporting requirements under fundraising legislation

All NPOs that undertake fundraising or fundraising appeals in Queensland, Western Australia and South Australia must submit audited financial records to the state regulator (see Table 9). Audited reports are mandatory in the Australian Capital Territory only for NPOs overseeing annual collections in excess of $50,000 and all incorporated associations operating in New South Wales, although records only need to be lodged in the latter case if directed to do so or when applying or renewing for a fundraising licence. NPOs fundraising in Victoria or Tasmania are expected to maintain records but there is no legal obligation to formally lodge them.

At least two jurisdictions—New South Wales and Western Australia—have developed best practice guidelines or codes of practice for public fundraising. These guidelines include recommendations around the provision of financial information regarding both format and detail to ensure accountability (NSW Department of Gaming and Racing 2002; WA Department of Commerce 2007).

Tax arrangements

NPOs may be eligible for a range of tax concessions from the Australian Government, including income tax, fringe benefit tax (FBT) and goods and services tax (GST), and deductible gift recipient (DGR) status. Eligibility for any of these concessions depends on the type of NPO, categorised by the ATO as:

- charities (ie public benevolent institutions, health promotion charities, charitable institutions and charitable funds);
- income tax exempt funds (ITEF); or
- other non-profit organisations (see Table 10 for ATO definitions).

The ATO has had responsibility for determining charitable status but this role will be assumed by the soon-to-be-established ACNC (see next section).

Organisations seeking tax exemption/concession or DGR status do so on a voluntary basis. They must first register with the ATO and may need to obtain an ABN and place the organisation on the Australian Business Register as well. An approximate 190,000 non-profit organisations are registered for tax purposes with the ATO (ATO 2009).

NPOs designated either a charity or ITEF can gain an income tax exemption if they have an ABN and have received endorsement from the ATO to obtain that exemption (ATO 2007a). If an NPO is registered to pay income tax, endorsement reduces the amount of tax payable. NPOs that are not charities

Table 9 Financial reporting and auditing requirements for non-profit organisations engaged in fundraising

Jurisdiction	Association type	Financial reporting and auditing requirement
NSW	Incorporated association	Statements only need be lodged when applying for a fundraising licence, renewing the licence or if directed to submit accounts by the Director of the Office of Liquor, Gaming and Racing *Audited accounts must be prepared*
	Unincorporated association if income from fundraising appeal exceeds $20,000	Lodge annual return on proceeds received from fundraising appeals
	Unincorporated association—other	None
Vic	All	Not required to lodge an annual return. Must keep records sufficient to enable a true and fair view of the income and expenditure relating to the appeal *Records must be audited only if directed to do so by the Director of Consumer Affairs Victoria*
Qld	All	Lodge an audited statement of income and expenditure, balance sheet and annual return *Audited by person registered as an auditor under the* Corporations Act *or member of CPA Australia who is entitled to use the letters 'CPA' or 'FCPA' or member of ICAA in Australia who is entitled to use the letters 'CA' or 'FCA' or member of the NIA who is entitled to use the letters 'MNIA', 'FNIA', 'PNA' or 'FPNA' or person who the Commissioner of the Office of Fair Trading considers has appropriate qualifications*
WA	All	Lodge an audited statement of income and expenditure and balance sheet *Audited by a member of ATMA, CA, NIA or CPA*
SA	All	Lodge audited accounts and fundraising income and expenditure statement *Audited by a registered company auditor, or a firm of registered company auditors; or a person who is a member of CPA or ICAA; or a person approved by the Corporate Affairs Commission to audit the accounts under the* Associations Incorporation Act 1985
Tas	All	None
ACT	Collections less than $50,000 in 12 month period	Report including 'all the required information for each collection to which the licence relates' *Audited by a registered company auditor under the Corporations Act; or an auditor approved in writing by the chief executive*
	Collections exceeding $50,000 in a 12 month period	*Audited report, as above*
NT	n/a	n/a

Note: CPA=Australian Society of Certified Practising Accountants, ICAA=Institute of Chartered Accountants in Australia, NIA=National Institute of Accountants, ATMA=Association of Taxation and Management Accountants

Table 10 Non-profit entities eligible for tax concessional status

Category	Definition	Concessions eligible for
Charities	An entity that is also a trust fund or an institution, exists for the public benefit or the relief of poverty, its purposes are charitable within the legal sense of the term, it is non-profit and its sole purpose is charitable	See below
Public benevolent institution	An entity that is set up for needs that require benevolent relief, relieves those needs by directly providing services to people suffering them, is carried on for the public benefit, is non-profit, is an institution and has as its dominant purpose the provision of benevolent relief	All
Health promotion charity	A non-profit charitable institution whose principal activity is promoting the prevention or control of diseases in human beings	All
Charitable institution	An institution that is established and run solely to advance or promote a charitable purpose. It may be an organisation established by will or instrument of trust; it may also have the legal structure of an unincorporated association or a corporation	Income tax exemption FBT rebate GST concessions[a] DGR
Charitable fund	A fund established under an instrument of trust or a will for a charitable purpose. Charitable funds mainly manage trust property and/or hold trust property to make distributions to other entities or people	Income tax exemption GST concessions[a] DGR
ITEF	An income tax exempt fund is a non-charitable fund that is endorsed by the ATO to access income tax exemption. It applies to non-charitable funds established under a will or instrument of trust solely for the purpose of providing money, property or benefits to income tax exempt DGRs, or the establishment of DGRs	Income tax exemption GST concession[b] DGR
Other NPO	Other non-profit organisations are non-profit organisations that are not charities, or income tax exempt funds. They include sports clubs, community service groups and recreational clubs	All[c]

a: GST concessions for charities and gift deductible entities and NPOs

b: GST concession for gift deductible entities only

c: For certain types of NPOs only

Source: ATO 2007a

or ITEFs do not have to be endorsed to access a tax exemption; instead they need to self-assess their entitlement against a standard set of tests and rules (ATO 2007a).

Other tax concessions, such as GST and FBT concessions, are available for some NPOs and follow similar procedures of endorsement. Any NPO with an annual turnover of less than $100,000 does not need to register for the GST (unless they choose to do so) and those that do have to register can apply for a concession (ATO 2007a). FBT concessions include exemptions and rebates, but are restricted to a smaller group of NPOs. For example, only public benevolent institutions, health promotion charities and some categories of 'other' NPOs are eligible for an FBT exemption.

Entities engaged in fundraising may additionally apply for DGR status that entitles the organisation to receive income tax deductible gifts. Endorsement for DGR status is a different procedure to that approving access to a tax concession and is dependent on several factors including the objectives of the organisation, its legal and internal structure and its financial accountability. DGRs listed by name (ie listed in income tax law following an amendment to the law by parliament) do not require endorsement.

Participation in the Overseas Aid Gift Deduction Scheme, which enables donations collected for overseas aid activities to be tax deductible, is also voluntary and dependent on AusAID accreditation of the organisation, as well as its verification by the Australian Government Department of Treasury and the Department of Foreign Affairs and Trade.

The ATO's regulation of NPOs is conducted through the submission of annual tax returns and reviews of tax concessions and DGR entitlements. NPOs with an annual taxable income of $416 or less (or those with ITEF status) do not have to file an income tax return. Other taxes are reported using a personalised activity statement, which the ATO generates for individual organisations (ATO 2007a). Entitlements are examined each year as part of the ATO's compliance program. The ATO's 2010–11 compliance program will look at issues such as the 'deliberate' misuse of tax concessions, the undertaking of activities not consistent with endorsed exemptions and reviewing the stated charitable purpose of selected charities (ATO 2010). Around 613 NPOs were reviewed between 1 July 2006 and 30 June 2010 to verify if current entitlements to concessions should be continued. The reviews saw the revocation of 132 DGR and tax concession entitlements (ATO 2009, 2008, 2007b). In 2007–08, the ATO also undertook a self-review of 410 entities registered as a charity, of which 21 had their charitable status revoked. No information was provided on these cases.

In addition to the tax concessions available at the Commonwealth level are exemptions granted by state and territory governments with respect to land and payroll tax, and stamp duty. These exemptions too have to be endorsed. For cross-jurisdiction NPOs, this entails having to apply multiple times to gain the same type of exemption in different states.

Self-regulation

To some extent, all Australian NPOs engage in self-regulation in that they rely on internal processes guided by material developed by peak bodies and relevant government agencies. Two peak bodies have been active in establishing codes of practice from which NPOs can 'demonstrate to funders, stakeholders and the public that they are upholding the highest standard of practice' (Productivity Commission 2010: 146). ACFID, the national representative body for non-government organisations engaged in international aid and development work, has developed a voluntary, self-regulatory code of conduct for non-government development organisations. The code contains provisions regarding organisational integrity, governance, communication with the public and finances (ACFID 2010, 2009). The code, which was amended in 2009, includes requirements that NPOs have procedures in place to ensure:

- funds and other resources will only be used for aid and development;
- funds and resources will be disbursed in accordance with laws relating to AML/CTF legislation;
- recipients are using funds and resources in accordance with the instructions provided by the NPO; and
- a minimal risk of misappropriation or improper use of funds and resources once they have been disbursed to a third party.

Signatories to the code are also expected to publish audited summary or full financial reports in their corporate publications. A Code of Conduct Committee monitors compliance with the code by examining annual reports, investigating complaints and overseeing investigation of inquiry into the practices of specified organisations.

The Fundraising Institute Australia (FIA) has produced a set of Principles and Standards of Fundraising Practice. The Principles are overarching codes that apply to all fundraisers relating to ethics, professional conduct, acceptance and refusal of donations, disclosure of information to donors and complaints processes (FIA 2007). The Standards address issues for specific fundraising activities, such as the Standard for Overseas Aid Fundraising Practice which lists measures to be taken to:

- check the credentials of overseas-based partners;
- organise the transfer of donations overseas; and
- manage and record finances.

Members of the FIA are obliged to abide by these standards but no overt compliance work is undertaken by the body.

Relationship with anti-money laundering/counter-terrorism financing laws

SR VIII advised countries to review laws and regulations relevant to the non-profit sector with the purpose of reducing any future opportunity or risk for terrorist or other criminal misuse. Unlike other recommendations, though, SR VIII refrained from endorsing any particular regulatory model for the sector; rather, it specified elements that comprise an effective regulatory response. However, in their 2005 mutual evaluation of Australia's AML/CTF laws, FATF concluded Australia had not, despite numerous reviews, instituted any new measures to diminish potential exploitation of the sector (FATF 2005).

The AML/CTF Act compels 'reporting entities' that provide a 'designated service' to implement customer identification procedures, put in place AML/CTF programs, report to AUSTRAC annually regarding their compliance with the AML/CTF Act and undertake ongoing customer due diligence. Designated services, elected as part of the first tranche of AML/CTF reforms, are broadly categorised as financial services, bullion, gambling services and prescribed services. The second tranche of reforms will further capture professionals and business entities such as lawyers, accountants, real estate agents and trust and company service providers.

The majority of NPOs do not provide services prescribed as a designated service under the AML/CTF Act. However, AUSTRAC (2008a) has interpreted the possible applicability of AML/CTF laws to parts of the non-profit sector. This interpretation is based on AUSTRAC's reading of non-profit activities and how these might be considered as falling within the AML/CTF Act's definition of what constitutes a business, that is, 'a venture or concern in trade or commerce, whether or not conducted on a regular, repetitive or continuous basis' (s 5).

Information sharing

Limitations on information-sharing can restrict the content and value of intelligence and other forms of information that can be disseminated. This is evidently the case where central or key regulatory partners are restricted by legislative provisions and related legal tools blocking the provision of information to equally key regulatory entities, either within or outside its jurisdictional field. While an analysis of information-sharing arrangements and its impact on the transmission of information is outside the scope of this study, Australia has enacted protocols to improve the flow of information.

As Australia's AML/CTF regulator, AUSTRAC has implemented financial transaction information-sharing arrangements (as prescribed in the AML/CTF Act) with an extensive group of Australian, state and territory agencies as well as established exchange instruments with almost 60 international financial intelligence units (AUSTRAC 2010b). Through these arrangements, AUSTRAC can undertake further checks related to suspicious behaviour and transaction reports or refer results to partner agencies and FIUs for further investigative action. In addition, AUSTRAC receives all reports of suspicious behaviour and transaction reports from designated entities. To this end, AUSTRAC will be alerted to suspicious transactions undertaken by NPOs which use designated financial channels to transmit funds.

The information-sharing arrangements involving other contributory actors in the regulation of NPOs includes data matching programs maintained by the ATO and assistance agencies (as prescribed in the *Data Matching Program (Assistance and Tax) Act* 1990), although these would not be relevant to the non-profit sector and any information-sharing protocols observed by incorporated association and state/territory fundraising and gaming regulators.

Comparison with other non-profit regulatory regimes

Depending on the country of interest, formal regulation of the non-profit sector spans the virtually non-existent to regimes that, according to FATF specifications, are well adapted to minimising exploitation of at least the more vulnerable components (eg charities) of the sector. None,

however, cover the whole of the sector and, like Australia, different levels of scrutiny are applied based on the legal form and activities of the organisation in question. Regulatory approaches adopted in the United Kingdom, the United States, Canada and New Zealand are described here to illustrate some of this variation and showcase regulatory models (or elements of these models) that have been suggested as improving regulatory oversight of the Australian non-profit sector.

United Kingdom

The non-profit sector in the United Kingdom is dominated by charities, in both value and profile, and hence non-profit regulation in the UK centres on this type of NPO (FATF 2007). An independent charity regulator has been established for England and Wales (the Charity Commission) and Scotland (the Office of the Scottish Charities Regulator) and is in the process of being established in Northern Ireland (the Charity Commission for Northern Ireland).

England and Wales

The Charity Commission registers and regulates charities operating in England and Wales. The Commission is governed by the *Charities Act 2006* and its key role is to facilitate and achieve compliance on the part of charities with the provisions of that legislation. Charities with an annual income of over £5,000 are required to register with the Charity Commission; those with an annual income of £5,000 or less are not obliged to register but are still subject to charity law. As of 30 September 2010, there were 162,440 registered charities in England and Wales (Charity Commission 2010e).

All charities are expected to submit an annual return to the Commission but the content of the return depends on the charities' annual income. Charities with an annual income of over £10,000 are required to submit a copy of their accounts with the annual return and charities with an annual income of over £500,000 must additionally submit detailed financial information on incoming resources, resources expended, assets and liabilities and other recognised gains and losses (Charity Commission 2009c). Independent assessment of accounts is mandatory for charities with an annual income of over £25,000 but an actual audit is obligatory only for those charities when their gross income is greater than £500,000 (Charity Commission 2009d). Charities with an income of more than £250,000 and with total assets greater than £3.26m are also expected to have their accounts audited.

Regulation of charities is achieved via a range of mechanisms including compliance monitoring and assessment (including examination of accounts and other financial information submitted in annual returns), the reporting of serious incidents, whistleblowing and disclosures from auditors. For serious concerns, the Commission can open a statutory inquiry under s 8 of the *Charities Act 1993* (as amended by the *Charities Act 2006*), which provides the Commission with a broader range of investigatory and remedy powers conferred under ss 18(1)(2) of the *Charities Act 1993*. The findings from the majority of these investigations are made available as inquiry reports. The Commission also publishes regulatory case reports on what it terms 'non-inquiry work', which are cases 'where there is significant public interest in the issues involved and the outcome, and where there are lessons that other charities can learn from them' (Charity Commission 2010f: 1).

A review of how the charitable sector might best be protected recommended that charities be encouraged to take a risk-based approach to the risk of terrorist exploitation (Home Office & HM Treasury 2007b). The approach would be premised on the provision by the Charity Commission of practical guidance on evaluating risk and taking appropriate and proportionate measures to mitigate abuse, along with ongoing feedback to the sector on global charity related terrorist threats. This strategy is described in more detail later in the section (see *Mitigation strategies*).

Pursuant to that recommendation, the Charity Commission created a risk proportionality framework that recognises the impossibility and/or impracticality of averting or controlling all prospective risks to the charitable sector (Charity Commission 2008a). Its approach utilises a 'traffic light' model that will elucidate how issues of concern arising within a charity should be handled and determine the level of response required from the Commission. Risks according to the model are categorised as:

- green or low risk, or 'routine matters that require less concentrated and/or immediate attention and support';
- amber or medium risk, or 'more complex issues that require more resources and support to resolve difficulties'; or
- red or high risk, or 'major and complex issues that present serious risk to the charity and its beneficiaries' (Charity Commission 2008b: 5).

The Commission has identified a number of the most serious issues and areas of greatest risk for charities (Charity Commission 2008b). When deciding when and how to respond to an issue, the Commission will use the risk and proportionality framework to determine the level of priority, attention and resources to be applied to it. Those serious issues are:

- significant financial loss to the charity;
- serious harm to beneficiaries;
- threats to national security, specifically terrorism;
- criminality and/or illegal activity within or involving a charity;
- sham charities set up for an illegal or improper purpose;
- charities deliberately being used for significant private advantage;
- situations in which a charity's independence is seriously called into question;
- issues that could damage the reputation of an individual charity or class of charities or the wider charity sector; and
- issues that could damage public trust and confidence in charities or in the Commission as an effective regulator.

The decisions will in turn be premised on the nature and scale of the problem and if any of a set of pre-determined 'zero tolerance' issues is involved, such as:

- charity links to or support for terrorism, financial or otherwise;
- connections to proscribed organisations;
- misuse of charity to foster criminal extremism;
- fraud and money laundering;
- abuse of vulnerably beneficiaries;
- lack of adequate measures in place to protect vulnerable beneficiaries;
- sham charities; and
- failure to take significant remedial action by trustees as required by the Commission.

Under the risk and proportionality framework, the Commission's response to the issue will consider a number of 'modifying factors' which may lead, for example, to an originally designated 'low' risk issue being re-classified as 'high' risk. Modifying factors include the public profile of the charity, the risk to the charity's reputation and risk of further harm to beneficiaries.

Scotland

The Office of the Scottish Charity Regulator (OSCR) serves a similar function to the Charity Commission. The regulator was established in 2003 under the *Charities and Trustee Investment (Scotland) Act 2005*, following recommendations from the McFadden Commission report that there be a single national regulator for charities operating in Scotland.

Charities must apply to OSCR to obtain formal recognition of their charitable status, which then enables them to apply elsewhere for charitable tax relief, grants and a reduction in business rates. Once registered, all charities are required to submit to OSCR an annual return and a signed copy of the annual accounts. Charities with a gross income exceeding £25,000 must also provide supplementary information on the charity and its finances (OSCR 2008).

The OSCR's anti-fraud strategy is described as 'risk-based (and) intelligence led' and employs principles of prevention, intelligence, intervention and improvement (OCSR 2010: np). The onus of detecting and reporting fraud is shared between trustees, auditors and other independent examiners, the public and OSCR. Suspected cases of fraudulent behaviour are assessed with reference to OSCR's Enquiry and Intervention Policy and available intelligence.

No specific guidance has been prepared by OSCR on preventing abuse of charities by terrorist groups. In its submission to the Home Office review, OSCR observed there had been no known terrorist activity involving Scottish charities but stressed its interest in developing guidelines with other regulators in the United Kingdom, albeit those that incorporated

assessment and approaches that were proportional to the actual (ie low) risk of terrorist abuse (OCSR 2007).

Northern Ireland

Northern Ireland is currently setting up a similar institution—the Charity Commission for Northern Ireland—under the *Charities Act (NI) 2008*. The Commission will be responsible for determining the charitable status of an organisation through the application of a public benefit test; maintaining a register of charities operating in Northern Ireland and performing educative and compliance functions, including identifying and investigating misconduct or mismanagement. It will be compulsory for all charities to register with the Commission and all will be legally obliged to submit an annual statement of accounts (*Charities Act (NI) 2008*, s 64). The Commission will assume an additional role of regulating 'public charitable collections' (ie any charitable appeal made in a public place (*Charities Act (NI) 2008*, s 131(2a)) and issuing permits to conduct such collections.

United States

Based on statistics provided by the US IRS to the FATF, the non-profit sector in the United States (in 2006) comprised more than one million charities and private foundations, with an additional 350,000 religion-affiliated or smaller charities exempt from having to register with the IRS (FATF 2006). Oversight of the non-profit sector in the United States combines federal and state government regulation, self-regulatory practices and the application of certification schemes. The FATF evaluation found the United States' AML/CTF regime to be fully compliant with SR VIII (FATF 2006).

NPOs that are suspected of being involved with terrorism financing may be designated by either Presidential Order (under Executive Orders 13224 and 12947) or by the Secretary of the Treasury. Once an entity is so designated, its assets are frozen and all future transactions blocked, and US citizens are prohibited from dealing with them. These entities are listed on the SDN and Blocked Nationals List which is maintained by the US Department of the Treasury's Office of Foreign Assets Control (OFAC).

Federal-level regulation sits primarily with the IRS Tax Exempt and Government Entities Division (IRS-TEGE). IRS-TEGE approves applications from non-profit entities seeking federal income tax exemption status, in accordance with s 501(c)(3) of the Internal Revenue Code. Entities must demonstrate they are being operated and organised for 'exempt purposes', which includes charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition and preventing cruelty to children or animals objectives (IRS 2009). Churches and equivalent bodies are automatically exempt from taxation. If an organisation chooses not to claim tax exemption they are monitored by the IRS as a tax-paying body. Compliance monitoring of tax exempt NPOs is achieved through examination of annual returns submitted to the IRS-TEGE and audits to determine whether entities are operating according to tax laws (FATF 2006). Part of the compliance monitoring involves cross-referencing names of applicants, directors and officers of NPOs with those on the SDN List.

State governments are responsible for regulating fundraising practices. In 2006, 39 US states required charities to register with the relevant government regulator if they planned to fundraise in that state (FATF 2006). Similar to Australia, fundraising laws and reporting requirements differ between the states and streamlining of processes is being considered. Self-regulation is supervised by a number of private bodies that act as an umbrella or watch-dog organisation for the non-profit (specifically charitable) sector (FATF 2006).

Outreach to the sector has been largely achieved through the release and updating of guidelines outlining voluntary best practices for entities operating as charities (US Department of the Treasury 2006b). The guidelines describe fundamentals for operation, such as governance and financial accountability and transparency, as well as procedures that should be followed in upholding fiscal responsibility in the supply of resources and services. The guidelines further include best practices to minimise the risk of funds diversion such as collecting detailed information and vetting all potential grantees, vetting staff and reporting any suspicious persons or activities to the appropriate authority.

Canada

The Canadian non-profit sector mostly consists of charities and other incorporated entities. In 2008, there were 825,000 registered charities in Canada and another 63,000 incorporated organisations (FATF 2008b). Charities accounted for 68 percent of all NPO revenue.

Three reviews of the Canadian non-profit sector identified charities, compared with other non-profit entities, as most at risk of abuse from terrorist organisations (FATF 2008b). The regulation of charities in particular was subsequently tightened but FATF noted that a large proportion of the NPO sector still remained outside regulatory coverage. FATF analysis of data from FINTRAC, Canada's Financial Intelligence Unit, revealed that more than a third of FINTRAC disclosures related to suspected terrorism financing were associated with NPOs (FATF 2008b). Suspect transactions largely involved the use of multiple accounts, the use of personal accounts by persons connected with NPOs and the movement of funds to areas of conflict.

While Canada's provincial governments have powers to make laws regarding the regulation of charities, charitable donations and charitable property, in reality only some have acted to introduce such legislation and then solely related to the regulation of fundraising. Ontario is the one province that has enacted legislation—the *Charities Accounting Act 1990*—for the purpose of regulating charities based in the province (Commission of Inquiry into the Investigation of the Bombing of Air India Flight 182 2010). These circumstances have meant that the federal government, in the form of the Canada Revenue Agency (CRA), has in effect become the 'de facto' regulator of Canadian-operated charities, through its powers prescribed in the *Income Tax Act 1985* (Monahan & Roth cited in Commission of Inquiry into the Investigation of the Bombing of Air India Flight 182 2010). Charities, unlike other NPOs, must register with the Charities Directorate of CRA. Registration is successful if the charity can demonstrate its activities meet the definition of a charity as defined in common law (ie meeting the public benefit test) and once registered, charities are immediately granted tax exemption status under s 149(1)(f) of the *Income Tax Act 1985*. All applications to the Charities Directorate are evaluated regarding their potential risk in being involved or exploited for terrorism financing purposes (Commission of Inquiry into the Investigation of the Bombing of Air India Flight 182 2010).

All charities are stipulated to submit to CRA an annual information return and financial statement (CRA 2009). Most of the information provided in the annual information return can then be made available to the public; CRA administers an online register documenting annual return information. In addition, CRA undertakes monitoring work whereby charities are selected at random or targeted for risk-based auditing processes.

CRA provides guidelines to charities in the form of a 'Terrorism checklist', outlining the type of checks charities should make to safeguard their organisation from terrorist abuse (CRA 2010). These checks broadly include:

- having familiarity with persons and entities listed as being associated with terrorism under the *United Nations Act* and the Criminal Code;
- knowing the background and affiliations of board members, partners, employees, contractors, fundraisers and volunteers;
- maintaining strict financial and other oversight over the collection, handling, depositing and transfer of funds;
- keeping appropriate financial records;
- ensuring funds are transferred, where possible, using normal banking mechanisms; and
- knowing the source and destination of funds.

Under the *Charities Registration (Security Information) Act 2001*, the Canadian Government can deny or relinquish registration of charities suspected of diverting resources to a listed entity as defined in subsection 83.01(1) of the Criminal Code. Since 2005, the CRA have also been able to apply intermediate measures to non-compliant charities, such as issuance of monetary penalties, but the agency still lacks powers related to the suspension or removal of trustees as available to the Charity Commission.

Non-charitable NPOs do not need to register with the CRA, other than that required to observe federal tax laws. Some NPOs can obtain tax exemption

status under s 149(1)(l) of the *Income Tax Act 1985* and need only file an income tax return if the organisation is incorporated, required to pay tax on property income or capital gains tax, or are directed to do so by the Minister. Unlike charities, annual information returns are mandatory for only a subset of NPOs, that is, those with total assets of more than Can$200,000 or organisations in receipt of taxable dividends, interests, rentals or royalties greater than Can$10,000 (CRA 2001).

Incorporated NPOs (or corporations without share capital) are also subject to regulation under the *Canada Corporations Act 1970* (Part II). This entails providing Corporations Canada (which sits within Industry Canada) an annual summary, as well as making available for inspection audited accounting and financial statements if requested.

CRA operates alongside FINTRAC and law enforcement agencies such as the Royal Canadian Mounted Police in the detection of charity-related suspicious behaviour. However, prior to the passing of Bill C-25 (An Act to amend the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* and the *Income Tax Act* and to make a consequential amendment to another Act, SC 2006), CRA (like many tax agencies) were observant of very strict rules around information disclosure (Commission of Inquiry into the Investigation of the Bombing of Air India Flight 182 2010). Bill C-25 introduced provisions to improve the dissemination of 'classes of information' between agencies involved in counter-terrorism financing activity.

New Zealand

In New Zealand, the non-profit sector primarily comprises four types of entities—charitable trusts and societies, incorporated societies, industrial and provident societies, friendly societies, benevolent societies and working men's clubs (FATF 2009). Each of these entities is subject to separate legislative provisions.

Charities in New Zealand are regulated by the Charities Commission, which was established under the *Charities Act 2005* in response to the recommendation from a 2001 examination of tax law reform for an improvement in the regulation of the charitable sector. The role of the Charities Commission is to register charities and monitor their activities with respect to eligibility for registration. At 31 March 2010, there were 28,814 registered charities in New Zealand and based on annual returns from 17,868 of these organisations, gained NZ$9.37b in total gross income in the previous financial year (Charities Commission 2010b).

Registration is voluntary but organisations must register with the Commission as a 'tax charity' if they wish to seek tax exemption (Charities Commission & Inland Revenue 2010). Charities must then apply to the Inland Revenue Department for income, FBT and/or resident withholding tax benefits under the *Income Tax Act 2007* or gift duty exemptions under the *Estate and Gift Duties Tax Act 1968*.

Other NPOs incorporated or registered under the *Charitable Trusts Act 1957*, *Incorporated Societies Act 1908*, *Industrial and Provident Societies Act 1908*, *Friendly Societies and Credit Unions Act 1982* or the *Companies Act 1993* are to register with the New Zealand Companies Office. Any such entity may also be registered with the Charities Commission if the organisation was established and is maintained for charitable purposes as defined in s 5(1) of the *Charities Act 2005*. Financial reporting obligations largely depend on the legal form of the NPO. These are as follows:

- Registered charities must submit to the Charities Commission an annual return, which includes the charity's financial accounts and a statement of its financial performance. There is no obligation to provide audited accounts:
- Entities registered under the *Charitable Trusts Act 1957* must provide the Registrar of Incorporated Societies (which sits within the Companies Office) with details on changes to trust deeds and rules but do not have to submit financial information.
- Non-profits incorporated under the *Incorporated Societies Act 1908* are legally required by s 23(1) of the Act to file a certified copy of their annual financial statement with the Registrar. Statements lodged with the Registrar do not need to be audited. Incorporated societies registered with the Charities Commission, however, only need to submit returns with the Commission as per their reporting requirements.

- Industrial and provident societies, unless subject to the reporting obligations of the *Financial Reporting Act 1993* (see below), are compelled under s 8 of the *Industrial and Provident Societies Act 1908* to file a statement of their financial position and an auditors' report.
- Friendly and benevolent societies must provide, as per s 61 of the *Friendly Societies and Credit Unions Act 1982*, the Registrar of the Friendly Societies and Credit Union an annual return and a copy of its financial statements. Accounts do not need to be audited if the receipts and payments of the society, or the value of its assets, did not exceed $20,000 in the previous financial year (*Friendly Societies and Credit Unions Act 1982* s 62(2)).

The *Financial Reporting Act 1993* stipulates financial reporting standards for companies and issuers categorised in the Act as either 'reporting entities' or 'exempt companies'. Reporting entities include issuers, overseas or subsidiary companies, companies that have one or more subsidiaries and companies with assets valued at more than NZ$450,000 or annual turnover greater than NZ$1m. While the reporting requirements stipulated in the *Financial Reporting Act 1993* do not currently apply to most charities, they do for some NPOs, such as industrial and provident societies that act as issuers. Financial statements must be prepared in accordance with Part II of the Act and in most cases must be audited; however, only a subgroup of reporting entities is expected to register financial statements with the Companies Office.

The New Zealand Government passed the *Anti-Money Laundering and Countering Financing of Terrorism Act 2009* in October 2009. The Act is in the process of implementation and will apply to casinos and financial institutions that perform financial activities as defined in s 4 of the Act. Some NPOs, albeit the minority, may be covered by the Act and will be required to undertake an AML/CTF risk assessment and design, and then following the assessment, a program to detect, manage and mitigate risk of money laundering and terrorism financing (NZ Ministry of Justice 2010).

In its mutual evaluation report for New Zealand, FATF stated that New Zealand had not conducted a comprehensive review of the non-profit sector's risk of terrorist abuse, nor did any of the current monitoring arrangements focus on identifying or dealing with suspected abuse (FATF 2009). Of particular concern to FATF was the absence of a risk-based monitoring program. The Charities Commission, in their guide for charities on terrorism and money laundering (Charities Commission 2010a), described the risk of exposure to terrorist abuse for NZ charities as being 'small' but outlined principles of good practice in circumventing any misuse occurring. The guide also refers to obligations under s 43 of the *Terrorism Suppression Act 2002* whereby all entities must forward a Suspicious Property Report to the New Zealand Police's Financial Intelligence Unit if 'they deal with property that is suspected to be owned or controlled by a designated terrorist entity' (Charities Commission 2010a: 3).

Mitigation strategies

At the core of government and non-government approaches to mitigate NPO abuse are broad frameworks of indicative good practice comprising governance and financial transparency procedures and suggesting the attaining of sound knowledge of donors and of beneficiary charities. Many of these frameworks are shaped by regulatory pragmatism in that the onus on responding to risk must inevitably lie with the entity that is being targeted. Suggested strategies combine checklists of risk factors and recommended procedures to minimise misuse, with the expectation that NPOs will use these frameworks to understand the threat, self-assess its exposure to risks and adopt the necessary responses. Table 11 illustrates basic principles in risk mitigation, as incorporated into the anti-terrorist financing framework produced by the Hong Kong Narcotics Division, Security Bureau in conjunction with the Hong Kong Social Welfare Department.

Australia

Alongside the codes of practice developed by peak bodies, the Australian Government has provided additional guidance to NPOs, specifically as to how they can reduce risks with respect to abuse by terrorist organisations. The *Safeguarding Your*

Table 11 Anti-terrorist financing framework
Good governance and financial transparency
Maintain information on the purpose and objectives of their stated activities and the identity of the person(s) who own, control or direct their activities, including senior officers, board members and trustees
Publish annual financial statements that provide detailed breakdowns of incomes and expenditures
Have appropriate controls in place to ensure that all funds are fully accounted for and are spent in a manner that is consistent with the purpose and objectives of its stated activities
Maintain, for a period of at least five years (and make available to appropriate authorities) records of domestic and international transactions that are sufficiently detailed to verify that funds have been spent in a manner consistent with the purpose and objectives of the organisation
Conduct transactions via regulated financial channels wherever feasible, keeping in mind the varying capacities of financial sectors in different countries and in different areas of urgent charitable and humanitarian concerns
Consider, with a risk-based approach, making reference to publicly available information, to determine whether any of their own employees are suspected of being involved in activities relating to terrorism, including terrorist financing
Know your donor and beneficiary charities
Undertake best efforts to document the identity of significant donors with due regard to donors request for anonymity and/or confidentiality of identity
Inform the donors of how and where their donations are going to be expended
Make best efforts to confirm the identity, credentials and good standing of their beneficiary charities
Conduct, with a risk-based approach, a reasonable search of public information, including information available on the Internet, to determine whether the donor/beneficiary charities or their key employees, board members or other senior managerial staff are suspected of being involved in activities relating to terrorism, including terrorist financing

Source: Adapted from Hong Kong Narcotics Division 2007

Table 12 Charity Commission's counter-terrorism strategy	
Awareness	The awareness component of the strategy involves the analysis of potential risk factors and the production of periodic bulletins outlining the current and evolving threat vectors. Furthermore, a toolkit, developed in partnership with the sector, seeks to provide advice to charity trustees on undertaking effective risk assessment
Oversight and supervision	The oversight and supervision segment of the strategy sees the Charity Commission, through its Proactive Monitoring Unit, taking a more proactive approach to the analysis of trends and to the profiling of risks and vulnerabilities in relation to terrorism within the sector. Thereafter, the Charity Commission monitors what it considers high-risk areas of the sector in order to identify threats at an early enough stage that remedial action might be taken In order to enhance the risk profile, hopefully achieved through awareness, oversight and supervision, via the cooperation strand of the strategy, the Charity Commission liaises through formalised and stronger operational arrangements with a range of government regulators and law enforcement agencies
Cooperation	Cooperation with law enforcement and other government regulators is enhanced by formalisation of protocols between agencies, provision of support falling under the remit of the Charity's functions and promoting reciprocal awareness education to assist other agencies if investigating abuse within the sector
Intervention	Through the intervention part of the strategy, the Charity Commission draws upon its gathered intelligence in order to disrupt the activities of those seeking to abuse charities for terrorist ends and seeks to build a counter-terrorism expertise within the sector

Source: Charity Commission 2008c

Organisation Against Terrorism: A Guidance for Non-profit Organisations guidelines (AGD 2009) sets out best practice principles for NPOs which in line with the FATF recommendations include:

- undertaking risk assessments of the organisation's activities;
- applying due diligence procedures with both beneficiaries and third parties;
- being aware of legal obligations; and
- ensuring internal processes of transparency and accountability are maintained.

The guidelines also advise NPOs to regularly check that beneficiaries and third parties are not listed individuals or organisations on either the 'Consolidated List' (ie persons and entities subject to a targeted financial sanction imposed by a resolution of the United Nations Security Council) or the 'List of Terrorist Organisations' (ie organisations proscribed by the Australian Government as terrorist organisations under Division 102 of the *Criminal Code Act 1995* (Cth)). The former list is maintained by the Department of Foreign Affairs and Trade and the second by the Attorney-General's Department.

NPOs, however, should not rely exclusively on these lists but continue to avoid engaging with any organisation they suspect of being a terrorist group. Under Division 102 of the Criminal Code, a court can deem an organisation a terrorist organisation

> if the prosecution can prove beyond reasonable doubt that the organisation is directly or indirectly engaged in, preparing, planning, assisting in or fostering the doing of a terrorist act (regardless of whether or not a terrorist act occurs) (AGD 2009: 11).

England and Wales

The Charity Commissions' counter-terrorism strategy emphasises the application of strong governance arrangements, financial management and partner management as critical to minimising terrorist abuse of charities (Charity Commission 2008c). Beyond that general injunction, the Charity Commission has created a four-stranded approach based on awareness, oversight, cooperation and intervention to guide its role in identifying and minimising the risk of terrorist exploitation of charities (see Table 12).

United States

OFAC has created a matrix of risk factors concerning the disbursement of funds to grantees (US Department of the Treasury 2007; see Table 13). The matrix is not supposed to be comprehensive in ambit and OFAC recognises for some charities, some of the risks highlighted could constitute normal business operations for those working in particular geographical and other contexts.

USAID employs a certification and vetting system to ensure that USAID funds and USAID-funded activities are not inadvertently being used to support terrorism. The certification process—the Anti-Terrorism Certification—requires any USAID grantee (both US and non-US non-government organisations) to certify that it will take all reasonable steps to ensure that they do not provide funds or support to any person or organisation involved in terrorism. Initially, a number of NPOs voiced their concern with the language used in the ATC. The US Government responded by revising the definition of 'terrorist act' in line with United Nations conventions and adding information on the type of measures NPOs should adopt to fulfil the requirements of certification (USAID 2005).

USAID also runs the Partner Vetting System (PVS), which vets individuals, directors, officers or other principal employees of NPOs who apply for USAID contracts, grants, cooperative agreements or other funding and of NPOs that apply for registration with USAID as private and voluntary organisations. The vetting process is designed to produce information that will then be used to ensure that USAID funds and USAID-funded activities are not inadvertently used to support terrorism. A number of the organisations invited to comment upon the PVS suggested that there was no evidence to suggest that USAID funds were being directed to terrorist organisations and that on that basis, the PVS was unnecessary. Despite these protests, USAID is intending to proceed with the PVS, arguing that the new system will not just improve due diligence and hence reduce the risk of USAID funds being diverted for terrorist purposes, but speed up the aid process (NARA 2009).

Table 13 Risk factors for charities disbursing funds or resources to grantees

Low risk	Medium risk	High risk
The grantee has explicit charitable purposes and discloses how funds are used with specificity	The grantee has general charitable purposes and discloses how funds are used with specificity	The grantee has general charitable purposes and does not disclose how funds are used
The charity and the grantee have a written grant agreement that contains effective safeguards. For example, provisions addressing proper use of funds by the grantee, delineation of appropriate oversight and programmatic verification	The charity and the grantee have a written grant agreement with limited safeguards	The charity and the grantee do not have a written grant agreement
The grantee has an existing relationship with the charity	The grantee has existing relationships with other known charities but not with this charity	The grantee has no prior history with any charities
The grantee can provide references from trusted sources	The grantee's references are from source with which the charity is unfamiliar	The grantee can provide no references or sources to corroborate references provided
The grantee has a history of legitimate charitable activities	The grantee is newly or recently formed, but its leadership has a history of legitimate charitable activities	The grantee has little or no history of legitimate charitable activities
Charity performs onsite grantee due diligence through regular audits and reporting	Charity performs remote grantee due diligence through regular audits and reporting	Charity performs no grantee due diligence, or due diligence is random and inconsistent
Grantee provides documentation of the used of funds in the form of video, receipts, photographs, testimonies and written records	Grantee provides documentation of the use of funds. Documentation may only include receipts and written records	Grantee provides no documentation of use of funds
The charity disburses funds in small increments as needed for specific projects or expenditures	The charity authorises grantee discretion engaged within specified limits	The charity disburses funds in one large payment to be invested and spent over time or for unspecified projects selected by the grantee
Reliable banking systems or other regulated financial channels for transferring funds are available and used by the grantee, subjecting such transfers to the safeguards of regulated financial systems consistent with international standards	Reliable banking systems or other regulated financial channels for transferring funds are not reasonably available for the grantee's relevant activity, but the charity and the grantee agree on alternative methods that they reasonably believe to be reliable, trustworthy and protected against diversion	The grantee does not use regulated financial channels or take steps to develop alternative methods that the charity and grantee reasonably believe to be reliable, trustworthy and protected against diversion
Detailed procedures and processes for the suspension of grantee funds are included within the written agreement and enforceable both in the United States and at the grantee's locale	Detailed procedures and processes for the suspension of grantee funds are included within the written agreement but may not be enforceable at the grantee's locale due to instability or other issues	There exist no procedures or processes for suspension of grantee funds in the event there is a breach of the written agreement
The charity engages exclusively in charitable work in the United States or in foreign countries/regions where terrorist organisations are not known to be active	The charity engages in some work in foreign countries/regions where terrorist organisations may be active	The charity primarily engages in work in conflict zones or in countries/regions known to have a concentration of terrorist activity

Source: US Department of the Treasury 2007

Other

In 2005, the European Commission developed a code of conduct for member states in their oversight of the non-profit sector (Commission of the European Communities 2005). The framework for the code of conduct encompasses all potential actors in the prevention and mitigation of NPO abuse based on four pivotal functions of oversight, promotion of compliance, outreach and risk assessment, and coordinated investigation of abuse (Table 14).

An interesting development in the monitoring of charitable organisations is the International Committee on Fundraising Organizations, a global forum for national charity monitoring agencies which aims, through its members' auditing activities, to relay reliable and objective information concerning the effectiveness and efficiency of the charities under review. The original and driving rationale for the International Committee on Fundraising Organizations, and to a large degree of its current membership organisations, was the countering of fraud by, or within, charities through the pursuit of transparency (Guet 2002). There seems no reason in principle, however, that auditing be recalibrated so as to include counter-terrorist financing in terms, for example, of the volume, flow, source and destination of charitable funding.

Sector misgivings

It has been suggested that rather than enhancing the ability of NPOs to mitigate the risks deemed to exist in relation to money laundering and terrorist financing, proposed measures to stem misuse not only place an undue burden on the sector 'without effectively tackling the terrorist threat' (Quigley & Pratten 2007: 11) but stigmatises and consequently disrupts non-profit activity (ACLU 2009; Cortright et al. 2008; Crimm 2008; Quigly & Pratten 2007). The discourse around finding appropriate solutions to

Table 14 European Commission Code of Conduct for non-profit organisations to promote transparency and accountability best practices

Oversight	Ways to ensure national cooperation
	• Operate a publicly accessible registration system for NPOs granted with tax relief, approved to fundraise and with access to public sector grants • Identify NPOs that fall outside the registration system and mitigate risks accordingly • Provide guidance on sector vulnerabilities and financial transparency • Coordinate detection and investigation of suspected abuse • Encourage tax authority review of NPOs granted tax relief
Encourage compliance	Offer tax relief, fundraising status and/or access to public sector grants to NPOs that fulfil registration requirements and comply with transparency and accountability measures Encourage peak bodies to establish 'seals of approval' for NPOs compliant with code of conduct
Outreach and risk assessment	Encourage NPOs to self-assess existing practices and make improvement to reduce risk of criminal or terrorist abuse Initiate awareness programs for NPOs on sector-specific risks and vulnerabilities Provide guidance to financial institutions, accountants, auditors and lawyers on methods of identifying suspicious financial transactions
Investigation of abuse	Coordinate both national and EU level cooperation and information exchange between relevant authorities

Source: Commission of the European Communities 2005

mitigate NPO misuse emphasises the difficulty in balancing risk with impact; however, among some of the sector's constituents and its commentators, there is a view that this balance, in practice, has gone awry.

The most immediate impact of changes brought in under the auspices of AML/CTF activities is the exposure of many more organisations to 'substantial, and inefficient, administrative burdens' (ACLU 2009: 35). Despite acknowledgement that a single regulatory model is inappropriate for a sector as diverse as the non-profit one, the practicalities of application has meant such a model has been retained or eventuated. The outcome for the sector has been one of 'over-regulation', or the potential for such (UK NPO peak body personal communication 2009). Smaller organisations have been identified as particularly disadvantaged as they possess fewer resources to deal with increasing regulatory costs. More stringent controls have also resulted in organisations, large and small, needing to divert more money away from the organisations activities to fulfil compliance requirements. Interviews with representatives from British oversight bodies such as the National Council for Voluntary Organisations and British Overseas NGO's for Development emphasised the need for more contact between regulators and the non-profit sector. Of particular importance was for regulators to revisit current definitions of risk to more clearly delineate levels of risk. Redefining risk would ideally be done with input from the non-profit sector and assessment should be evidence-based.

Perspectives on Australian regulation

Representatives from Australian NPOs participating in the AIC roundtable were strongly in favour of self-regulation. The current system, where each state and territory has a different regulatory system relating to non-profit activities, placed a considerable burden on NPOs and simplification of this situation was seen as a priority. In their view, self-regulation best enabled organisations to adapt to the rapidly changing nature of the sector. There was support for initiatives such as the guidelines prepared by AGD because they provided the sector with a summary of the relevant issues but left it to individual entities to determine how best to address these issues in detail. Similarly, there was endorsement for the codes of conduct developed by peak bodies. It was envisaged that such government initiatives would be complemented by an increased role for peak bodies in both disseminating current information regarding threats and providing more education to the sector as a whole.

There was consensus from NPO representatives that AML/CTF measures were expensive to both implement and monitor, although no details were given on how expensive such measures have proven to be. There were concerns that AML/CTF measures could also alienate potential donors who would not wish to see their donations being spent on internal administration and regulation. Reputation, it was suggested, was a crucial factor in ensuring that NPOs were sensitive to AML/CTF issues and adhered to tightening related operational processes—any media indication that charitable funds had been misused would destroy the donation base of any NPOS and would also put at risk its DGR status, without which it could not operate. Representatives suggested that the Australian Government had made a substantial investment in the non-profit sector through the granting of DGR status and that the government should protect that investment by providing financial assistance to NPOs with regard to activities such as training staff in AML/CTF issues.

One representative commented that the AusAID accreditation process was a useful regulatory process because it compelled NPOs to focus on governance issues. Australian NPOs accredited by AusAID are subject to regular spot checks and are investigated for any reported breaches. The ATO was seen as not being as proactive as it could be and lacked sufficient sector knowledge to make good decisions regarding what constitutes charitable activity.

The academic roundtable suggested that activities such as money laundering and terrorism financing may be quite different, but that events had led to them being addressed by the same regulatory regime and ideas, which may distort how both issues are handled. With regard to how effective the non-profit sector was in addressing these issues, one participant commented on the difficulty of

obtaining information regarding the financial arrangements of NPOs operating in Australia and contrasted the situation unfavourably with that in the United States.

Academic participants saw it as a role of government to educate the donor community and increase the level of involvement in where money is actually going. There was some concern that existing laws relating to the non-profit sector were not being enforced with sufficient robustness, with the suggestion that the ATO should be more proactive in assessing whether NPOs should be granted and/or retain their tax-exempt status. Perspectives from the law enforcement sector were slightly different again. A number of participants believed that NPOs, on the whole, knew little about the risks of money laundering or terrorism financing and how best to mitigate such risks. Without more sustained regulation, such as a national regulator similar to the Charity Commission (see below), any supervision was considered to be 'second hand'. Of particular concern was the practice of informal giving. Bringing informal giving into the regulatory fold might mitigate some of the risk associated with the non-profit sector but successfully disrupting or regulating an informal process was viewed as extremely difficult, if not impossible.

There was general support from the three sectors for the idea of a national regulator such as a Charity Commission in Australia (see next section). All were in agreement that the current regulatory system was not particularly effective in identifying non-compliant or criminal behaviour and a Charity Commission, if modelled on the UK version, would provide the proactive response to compliance monitoring that is generally missing in Australia. However, the NPO sector was the least enthused about the concept. While an independent Charity Commission-like body could provide much needed training and assistance in capacity building and risk mitigation, it would constitute yet another layer of regulation and would not address the issue of conflicting state/territory requirements.

Conclusion

Regulation of the non-profit sector has traditionally relied upon self-regulation for the majority, combined with formal government oversight directed at specific group of constituents (eg fundraisers). The Australian regulatory regime is multi-layered, divided between the Commonwealth and the states and territories, and comprising laws around incorporation, fundraising and the granting of tax exemption status. With this breadth of laws and regulators comes a variety of reporting obligations, which even for the same NPO can prescribe or waive compliance requirements depending on the jurisdiction(s) it operates in. Many Australian NPOs, though, sit outside the regulatory system. Self-regulatory codes of practice are available for regulated and unregulated bodies alike and include recommendations around financial management and disbursement of funds. Regimes adopted in the United States, United Kingdom, Canada and New Zealand are different again. Non-profit regulation in the United States and Canada is dominated by the federal tax authority and in the United Kingdom by a specialist charity commission. In New Zealand, it is spread across a charities registrar, tax authority and companies regulator. Self-regulation plays an important subsidiary role, as it does in Australia.

Among Australian stakeholders consulted for the report, regulation in its present model was described as flawed—it was unnecessarily cumbersome, too disconnected and devoid of appropriate sector outreach and education. Comprehensive knowledge of AML/CTF was generally missing and there was little financial or other support to enable organisations to get across policy and assist them in strengthening governance and financial management issues. The solution proposed was not to 'take regulation any further' (ie draw even more entities underneath the regulatory umbrella) but to refine current approaches or introduce models that have worked overseas (eg the UK Charity Commission) to assemble a select group of organisations—based on proportional

representation, total revenue and/or at greatest risk of misuse—for monitoring purposes. No regulatory model can capture every entity and the result, if all entities were captured, would be impossible to manage and potentially introduce more opportunity for misconduct.

Changes in policy, regulation and legislation have acted to bring a larger segment of the non-profit sector under more sustained scrutiny. In the wake of SR VIII, charities have perceptibly been the target of regulatory amendment and subjected to greater scrutiny. For some in the sector, this has been interpreted as a move in the direction of over-regulation, typified by the induction of substantial reporting requirements and directions to implement costly AML/CTF strategies in-house. Just as critical to the charitable sector is the perceived drop in confidence the often very public scrutiny has produced. At its most detrimental, policy changes (or at least those developed in the United States) may have inadvertently 'weakened mainstream, 'controllable' [charities], while building up informal, unchecked, and potentially dangerous charitable and donor networks' (Warde 2007: 147). The politicisation of the issue of terrorist financing by NPOs renders the mitigation of potential abuse all the more difficult (Centre for Civil Society 2007). Civil society is driven by humanitarian desire. Regulation of NPOs is driven and maintained by trust. Arguably, trust in regulatory terms cannot be sustained in the event of perceived or actual exhaustive regulation.

Minimising abuse: Balancing risk with impact

The propensity for the abuse of the non-profit sector by, or on behalf of, terrorist organisations or other criminal groups remains a threat and efforts are therefore deemed necessary on the part of government and the non-profit sector to mitigate the likelihood of exploitation. These efforts, however, must be counterbalanced with the available evidence that indicates the actual exploitation of NPOs for money laundering or terrorism financing purposes is arguably much lower than what has been alleged. To successfully mitigate the risk of abuse, the non-profit sector must remain mindful of the potential vulnerabilities and of the concomitant need to ensure that such vulnerabilities are identified and minimised. Equally, responses from outside the sector must be both appropriate and proportionate, and recognisant that exposure to risk is, for most of the sector, very low (Home Office & HM Treasury 2007b). Instituting a 'one size fits all' approach may have the adverse outcome of being both counterproductive in minimising overall risk and damaging to the sector as a whole (Home Office & HM Treasury 2007b).

Quantifying risk

In contrast with other FATF recommendations, SR VIII was less prescriptive in that it advised jurisdictions to analyse the level of risk of the non-profit sector to money laundering and terrorism, and to decide what changes to legislation, policy and regulatory practice were needed to counter this risk. SR VIII provided considerable interpretative scope for jurisdictions on which to modify approaches to monitor the non-profit sector. The 2005 FATF mutual evaluation of Australia's AML/CTF regime had concluded more could be done to protect the Australian non-profit sector from misuse.

Critical to the proposal and development of appropriate response strategies is the careful evaluation of risk, both potential and actual. It is apparent there are quite different viewpoints regarding the non-profit sector's real exposure to misuse and terrorist and money laundering abuse in particular. The governance and financial management weaknesses described as characteristic of some, but not all, NPOs have been used to support the conviction that the potential for misuse is quite high. Those organisations identified as most susceptible are charities, and in particular faith-based charities, and smaller entities that do not necessarily have the resources (or the inclination) to commit to due diligence and similarly recommended procedures. While the former ordinarily come under the notice of some form of regulatory scrutiny, be it from a specialist regulatory body or through monitoring of tax and fundraising arrangements, the latter often evade formal monitoring because they fall below

stipulated reporting thresholds. Completely outside this sphere of scrutiny are the informal and unincorporated entities, which comprise almost three-quarters of NPOs operating in Australia. It is this group that has been identified as the most vulnerable component of the sector, partly because they are generally not formally monitored and are much less likely to have adopted (or become aware of) recommended best practices in governance and financial management.

Abuse of the non-profit sector is evidently occurring but the amount of publically available firm evidence indicates that the incidence of abuse (in the form of money laundering and terrorism financing) is only moderate, if not low. The OECD study on the misuse of charities in 19 mostly European and North American nations, described earlier in the report, found variable rates of abuse between the countries surveyed. Much of this misuse involved charities and comprised tax evasion schemes and other tax-related fraud, with some money laundering schemes detected. While terrorism financing was outside the scope of the survey, just three countries (the United States, Canada and Italy) reported terrorist organisations and supporters as 'sectors and occupational groups involved in the abuse of charities' (OECD 2008: 15). Other documented cases of non-profit abuse, with respect to money laundering and terrorism financing, are also small in number. Most cases (and typologies) involved corruption of legitimate charities, or the establishment of sham charities by terrorist groups and their sympathisers, but the predominance of this category of abuse, compared with incidents of money laundering, may reflect political focus rather than actual prevalence.

The potential for risk to the Australian non-profit sector, according to participants in AIC-held roundtables and consultations, is credible but the likelihood of exposure was still considered minimal. If basing an estimate of risk on actual cases detected (and identifiable in public source material) then the risk for Australia can only be concluded as low. There have been a handful of cases where it was reported that an NPO was suspected of having links with terrorism and just one case that proceeded to trial. Equally, there is slender evidence of the non-profit sector's involvement in money laundering.

Potential risk, however, ultimately determines response but as it has been claimed elsewhere, the potential for risk is not considered to be proportionate among the disparate entities that comprise the Australian non-profit sector. Risk primarily lies with that subset of entities that collected and dispersed donations, used informal methods of funds transfer and/or were unregulated. However, while there is concordance in the types of NPOs that are more likely to be abused and their generic points of vulnerability, the measurement of risk and the development of risk-based management strategies must incorporate what typologies involving Australian NPOs reveals about actual vulnerabilities.

Before discussing the nature of these vulnerabilities, it is worth repeating what reported typologies reveal about where the abuse is occurring. All involved charities, many of which were in fact incorporated or otherwise under some regulatory observation. Also of relevance was that involved charities had often used formal, rather than informal, means of funds transfer. Several of these findings are seemingly at odds with aforementioned opinions on where exposure to risk is likeliest. The general absence of unregistered or unregulated organisations in documented typologies and case studies could signify that detection is only possible with increased or formal scrutiny. It could also mean that registered entities are chosen to instil a veil of legitimacy (and lack of corruptibility) to their operation and provide opportunity for a larger fundraising base.

Vulnerabilities in the Australian non-profit sector

The Australian non-profit sector is no less immune to the suite of vulnerabilities that have been categorised for NPOs. Nonetheless, representatives from law enforcement, academia and the non-profit sector consulted for the report collectively maintained that while the risk exists and should be taken seriously, the size of the problem was comparatively low and 'should not be inflated' (Roundtable participant personal communication 2009). This assessment was based on the limited evidence for abuse of Australian NPOs and an understanding that many NPOs had established processes that adhered to

peak body codes of conduct and government guidelines to both identify and guard against misconduct. Reputation is critical to the non-profit sector, especially for organisations that depend upon government grants and/or public donations, and many in the sector do take precautions to avert abuse. As one roundtable participant explained 'the risk is probably small but any hint in the media and you're dead' (Roundtable participant personal communication 2009).

Organisations particularly exposed to the risk of misuse were the smaller, local, community-based NPOs that fell outside regulatory scrutiny and which did not necessarily have familiarity with AML/CTF issues nor the expertise or resources to recognise, address or mitigate issues related to money laundering and terrorism financing. Keeping abreast of legal requirements is difficult enough for regulated NPOs but smaller, unincorporated entities, which have irregular or little contact with regulators or peak bodies, are less likely to be aware of the full breadth of issues now delineated for the non-profit sector. A deficiency in sector outreach and education is seen as partially responsible for the lack of awareness.

Related to this concern about the vulnerability of smaller NPOs, especially the less formal charities formed around ethnic and faith-based communities, was the preferred or common use of informal methods for the collection and transfer of funds. The identity of donors may not necessarily be pursued by the charity for cultural or other reasons and funds are known to be relayed to overseas locations using remittance services or similar methods of informal funds transfer. Money service businesses such as ARS are 'prone to ML/TF activity' (AUSTRAC 2010c: 13) and 'using ARS can disguise intentions' (Roundtable participant personal communication 2010). The vulnerabilities of alternative remittance in Australia, as examined in a previous study by the AIC (Rees 2010a, 2010b), 'often appear(ed) to relate more to a lack of knowledge than deliberate misconduct' (Rees 2010b: 4). The study found variable knowledge among smaller providers about their obligations under the AML/CTF Act and some providers admitted to difficulties in adhering to AML/CTF regimes, primarily related to the time-consuming and complex nature of reporting requirements. The concerns referred to by some providers interviewed for the AIC study included the amount of paperwork required to achieve compliance, the frequency of reporting requirements and the subsequent time implications for the business (Rees 2010a).

Since large alternative remittance providers were seen by users interviewed for the AIC study as being very expensive (Rees 2010a), smaller NPOs may opt to use the services of a smaller provider to keep costs down. Corrupted NPOs may also choose to deal or work with smaller providers to better conceal money laundering or funds diversion activities. AUSTRAC (2010c) has acknowledged that smaller or unaffiliated providers are difficult to formally monitor and the risk of misuse is therefore greatest for this group of remitters. Detected cases of remittance misuse in Australia, the United Kingdom and the United States have been mostly criminal in nature and none appear to have involved non-profits as victims or perpetrators (Rees 2010a). There is little evidence for a connection with terrorism financing, although Rees (2010a) did note that assessing the level of involvement was restricted by the scarcity of available information on terrorism investigations.

It may be unwise to assume, however, that larger Australian NPOs are inherently less vulnerable to misuse, particularly charities and other organisations that collect and distribute funds. For example, if a large NPO retains multiple offices in different countries that do not jointly adhere to uniform standards on performance and accountability, then their structure may make them more vulnerable than their size suggests. There are also limits to how much NPOs can realistically discover about the credentials of their overseas partners or influence their mode of operation. As one participant noted:

> Many [Australian charities] have large numbers of partners and even if the [charity] has good standards there is no guarantee the partners do. You [often] can't do anything about partner's standards' (Roundtable participant personal communication 2009).

Even among the well-established and commonly known NPOs who have implemented due diligence processes, such careful attention may have to be forfeited when, for example, coordinating disaster and other emergency relief.

The roundtable discussion also included references to Australia's approach to regulating the non-profit sector and how this influenced risk. The inherent difficulty in monitoring and disrupting informal processes means that some illegal activity will inevitably go undetected but problems also lie with procedures used to examine registered bodies. It was concluded that regulation was not doing what it was supposed to do and for a number of observers, the sector suffered because there was 'no strong cop on the beat'. The ATO, in particular, was seen as a 'powerful instrument to make people do the right thing' but it did not have enough knowledge of the non-profit sector and was not proactive enough in reviewing registered entities. ASIC was only 'nominally involved' and there were questions from a couple of participants about the thoroughness of the AusAID accreditation process.

State and territory regulation was described as 'a mess', inefficient and exacted significant administrative demands on organisations, which lessened confidence and increased the risk of failure. The primary risk, however, lay with the varied financial reporting requirements and exemptions specified for NPOs, and the absence of standardised accounting practices for presentation of financial records. Inconsistency provided the opportunity to distort or conceal the financial picture and potentially for criminal misconduct.

Regulatory reform and risk mitigation

It is clear that the Australian non-profit sector could be better regulated, either in a formal sense or in combination with self-regulation and sector outreach initiatives. It is also apparent from the available data, and notwithstanding the vulnerabilities outlined above, that the risk of NPOs being used to launder money or sponsor terrorism is low in Australia. An optimal scenario may be to introduce a system that simplifies the regulatory environment in which NPOs currently operate and creates a more streamlined approach by which the risk of mismanagement, misconduct or more serious abuse of NPOs is potentially minimised. Roundtable participants emphasised that the most pragmatic and effective approach should be based on the understanding that different tools were needed for different constituents, since the diversity and size of the sector made complete regulatory capture impossible.

The Australian non-profit sector has been the subject of numerous reviews, all with the intention of recommending regulatory reform (ACG 2005; CDI 2001; Productivity Commission 2010; Senate Standing Committee on Economics 2008; Woodward & Marshall 2004). While each of these reviews followed slightly different lines of inquiry, all recognised the unnecessary complexity of the current system, its lack of transparency and accountability, and the potential loss of confidence both with, and within, the sector. The reviews all recommended extensive reform, little of which has been implemented.

None of the aforementioned inquiries were commissioned to examine how the non-profit sector might be used for illegal means and the practical measures needed to circumvent such misuse. Nevertheless, some of the recommendations described below, which replicate recommendations published in the aforementioned reviews, represent options either adopted in overseas jurisdictions to assist in combating abuse, or are assessed in this study as potentially contributing to the mitigation of risk.

A single national regulator?

The implementation of a single national regulator has been proposed as the best regulatory candidate to both reduce complexity and improve transparency and accountability (see Productivity Commission 2010 (Recommendation 6.5); Senate Standing Committee on Economics 2008 (Recommendations 3 & 4); Woodward & Marshall 2004 (Recommendation 1)). The structure and function of the regulator as conceived by the Productivity Commission (2010) would model that of the Charity Commission in England and Wales and have responsibility for:

- registration and regulation of NPOs (not just charities) incorporated under Commonwealth law;
- registration and endorsement of NPOs for tax concessional status; and
- registration of national fundraising entities and activities.

The regulator would additionally serve as a 'single portal' for all financial, tax endorsement, fundraising and other reporting commitments. In effect, the breadth of regulatory functions presently spread across different government departments, different levels of government and different jurisdictions would be merged into the one authority for all applicable entities. The outcome would be a reduction in duplication of effort currently experienced by many in the non-profit sector and the installation of a single overseer to examine governance and financial information. Similar entities would be subject to the same level of scrutiny and the consolidation of monitoring activities into the one body, in theory, would improve detection of wrongdoing.

Together with conventional regulatory functions, the Australian national regulator might assume investigatory and related powers similar to those of the Charity Commission, which permit active monitoring and the application of enforcement action(s) onto NPOs at significant risk of misconduct or mismanagement. For example, under s 19 of the *Charities Act 2006* the Charity Commission has powers to suspend or remove trustees from charity membership; and following receipt of a warrant from a justice of the peace, s 26 of the Act grants the Commission with powers to enter premises and seize documents for investigatory purposes. These and related powers allow the Charity Commission to take remedial or protective action as warranted.

Ideally, the regulator would also host an online register similar to those compiled by the Charity Commission and the Charities Commission. Registers can be used to summarise information on the activities, location, financial history and compliance record of all registered organisations. Not all Australian NPOs make their annual reports or data on financial accounts available to the public, which limits the Australian public in their decision-making about which NPOs to donate to or otherwise support. Donor knowledge is a powerful instrument—'the more donors are brought into organisations which have proper processes, the less you have to worry about' (Academic roundtable participant personal communication 2010).The Australian Government announced in its August 2010 election campaign the proposal to establish an Office for the Non-Profit Sector in the Department of Prime Minister and Cabinet and the commencement of a study addressing the role and functions a 'one-stop-shop' regulator might take (Bowtell et al. 2010). In January 2011, the Australian Government released a consultation paper inviting comment on the possible roles and responsibilities of a national not-for-profit regulator (The Treasury 2011). Much of the paper's content reiterates options outlined in previous reviews of the non-profit sector, including the form and scope of a national regulator, its functions with reference to the granting of tax concessions, compliance and education responsibilities, and administration of fundraising legislation, and the need for a statutory definition of charity.

The promotion of a single national regulator, in this context, suggests that the currently fragmented system of NPO regulation increases the sector's risk to money laundering and terrorism financing. It could be contended that concentrating regulatory function into the one entity, and streamlining reporting procedures, reduces the opportunity for deception. Conversely, it may also be contended that a further tightening of regulation could act as a trigger for some entities to remove themselves from regulatory oversight, thus increasing the number of unregulated entities who are already perceived at greater risk of criminal or terrorist exploitation.

NPOs have argued that the diversity of the sector precludes a one-size-fits-all model of regulation and this presumably includes the consolidation of regulation by government. The abdication of some regulatory responsibility from government to other actors is embedded in the concept of regulatory pluralism, which advocates the use of a mix of regulatory instruments or regulatory partners in place of a single instrument approach (eg see Gunningham & Sinclair 1999). Regulatory pluralism has been applied to areas that have necessitated non-traditional models of regulatory action, such as environmental protection.

The Australian Government announced in the 2011–12 Federal Budget that it would provide $53.6m over the course of four years (2011–15) to establish the ACNC. The ACNC, which will commence operation on 1 July 2012, will have responsibility for determining charitable, public benevolent institution and other non-profit status; providing education and sector outreach to NPOs and developing a simplified reporting framework

(Australian Government 2011). Consequently, the ATO will no longer be involved in determining the charitable status of NPOs applying for tax relief but will still be responsible for administering tax concessions. Alongside the establishment of the ACNC, the government will begin discussions with state and territory governments regarding the future implementation of a national regulator for the non-profit sector. It is not known at the time of writing what form this regulator might take but its purpose will be to 'minimis(e) reporting and other regulatory requirements through coordinated national arrangements' (Australian Government 2011: 322).

The operation of a single national regulator does not discount the usefulness or the role of other regulatory contributors. Its primary function is to streamline regulatory reporting and improve transparency, a function described by participants in the AIC roundtables as vital in reducing non-profit misuse. However, the nature of the sector and the reality that not all entities will come under observation demands regulatory pragmatism and the involvement at some level of the sector itself.

How these arrangements work in practice requires further exploration and dialogue between the regulatory partners and the non-profit sector. Nevertheless, the non-profit sector has shown general support for a co-regulatory arrangement. In a 2010 survey of 1,536 NPOs, 93 percent stated their support for a national regulator (Pro Bono Australia 2010) and submissions to the Senate Standing Committee on Economics (2008) and Productivity Commission (2010) reviews suggested that the majority of the sector were in favour. Nonetheless, despite the support for a national regulator, the non-profit sector still has underlying reservations about government assuming greater or full regulatory control since many members saw self-regulation as the ideal option. Sixty-nine percent (n=973) of organisations participating in the aforementioned surveyed preferred co-regulation (ie an 'appropriate balance' of government and self-regulation) compared with 23 percent who stated that government should be solely responsible for regulation.

Harmonising existing laws and consolidation of legal forms

> There is never-ending change and making sure that you know what you need to know is a challenge. Getting across all this stuff is hard and expensive and you have to get it right (Non-profit sector participant personal communication 2010).

Given the size and variety of the non-profit sector, not all NPOs will be captured (by eligibility or by choice) in a national regulator. To ease what has been described as complicated and duplicative administrative obligations, Commonwealth, and state and territory governments should also attempt to obtain greater harmonisation of existing laws and/or adoption of model legislation (ACG 2005 (Recommendation 7.4); Productivity Commission 2010 (Recommendation 6.2)). Legislative harmonisation and mutual recognition of registration across jurisdictions brings its own costs and how this might be achieved alongside support for a single national legal form requires further exploration (Productivity Commission 2010). It would, however, reduce compliance burden and at the same time help to eliminate jurisdiction-shopping and minimise inconsistent (and potentially fraudulent) reporting.

To facilitate the establishment of a national regulator a single national legal form is preferable, if not essential (Senate Standing Committee on Economics 2008 (Recommendation 7); Woodward & Marshall 2004: Recommendation 5), as is a procedure that allows organisations that choose to come under the national regulator to do so at minimal cost. If such a form were applied, disclosure regimes are likely to be adjusted to a tiered system of reporting, such as that used by other Charity Commission-like bodies. In this scheme, NPOs falling under a specified annual revenue threshold would be relieved from submitting annual financial statements.

The adoption of a single national legal form may not suit some categories of NPOs, which at present are accommodated (if somewhat imperfectly) by the range of legal forms available. Further, despite assurances around costs minimisation, migration to new legal forms would still be difficult for some

NPOs, particularly smaller associations. It was recommended by the Productivity Commission (2010) that it be made simpler for non-profit bodies to adopt new legal forms as circumstances require. Relaxing the compliance and monetary costs associated with converting to, and operating as a company limited by guarantee, for example, has the potential to encourage more NPOs to transfer to the proposed Commonwealth legal form. It would also add to the number of associations falling under the aegis of the national regulator.

Non-profit organisations and providers of designated services

The activities of the majority of Australian NPOs do not fall within the AML/CTF Act's definition of a designated service. However, financial transaction activity involving an NPO should, in principle, be identified by the providers of designated services the NPO uses to deposit and transfer funds, unless it regularly makes use of unregistered, informal services. For example, when an NPO deposits cash over $10,000 into a bank account, or when they remit any amount overseas either through a bank or a remitter, both of these transactions should be reported to AUSTRAC by the bank or remitter as threshold transactions and international funds transfer instructions respectively. This would also apply to transactions that originated from other parties to NPOs as the beneficiary. Further, obligations to report suspicious transactions combined with FATF Recommendations and AUSTRAC guidance on AML/CTF risks to NPOs, should see reporting entities apply a higher level of due diligence when providing services to NPOs.

Standardising annual and financial reporting

There is no uniform accounting or reporting standard for the Australian non-profit sector. The content and standard of financial reporting depends on the NPO's legal form, its size (usually based on annual revenue or assets) and the jurisdiction(s) the organisation is incorporated or fundraises in. An Institute of Chartered Accountants Australia (ICAA) review of non-profit financial reporting found 'considerable variation in key reporting practices' (ACG 2005: 23), resulting in a scarcity in 'relevant' financial information on the sector and reduced accountability and transparency (ACG 2005). Woodward and Marshall (2004) also commented on the lack of standardisation in data collection and reporting and recommended the introduction of an NPO-specific accounting standard (see Recommendation 7).

ICAA, in their submission to the Productivity Commission's review of the non-profit sector, argued that recent developments in standards of accounting and corporate governance have yet to be incorporated into legislation relevant to the sector, contributing to the variability in financial reporting produced by the non-profit sector (Productivity Commission 2010). Adding to the problem is the 'little guidance' the sector has received as to how financial reporting standards that were primarily designed for the for-profit sector should be applied to non-profit reporting (ACG 2005: vi).

One initiative to achieve standardisation in reporting is being undertaken by the Australian Accounting Standards Board, which is assessing changes that could be made to disclosure regimes used by *private sector* NPOs to improve transparency and comparability (AASB 2010). The project will consider information that is incorporated into and currently outside of conventional disclosure regimes, to ascertain disclosure items that should be included, those that could be dropped and items that need some remodelling to better meet the needs of the sector. ICAA has also been active in this area, focusing on improving transparency through enhanced annual reporting. NPOs were recommended to pay particular attention to introducing more detail on mission and objectives and governance arrangements, clearer narrative on revenue and expenditure data, and using standardised measures of efficiency (or KPIs; ICAA 2007, 2006).

Regulating the unregulated

Largely excluded from the discussion on regulatory reform are the entities that comprise the largest proportion of the non-profit sector—the small, informal, unincorporated association. This is the group that is considered at greatest risk of exploitation but where less can be practically

achieved in eradicating misuse. It has been suggested that Australia could begin to address this problem by introducing a minimal legal entity by which unincorporated associations would gain some of the benefits of incorporation but without the more taxing compliance requirements normally associated with registration (Productivity Commission 2010). It would also offer some recourse to regulatory oversight. The risk in introducing a minimal legal entity, according to a Victorian Government submission to the Productivity Commission review, is for already incorporated smaller associations to switch to the new form in order to avoid more overt regulatory oversight (Productivity Commission 2010). The easiest option it seems is to retain the status quo but to encourage higher rates of incorporation through the aforementioned simplification of migration between different legal forms.

Conclusion

The non-profit sector is quite a separate body compared with the other entities and services covered by FATF recommendations regarding the suppression of terrorism financing and money laundering. For this reason, its regulatory treatment should take a separate form. NPOs exposure to money laundering and terrorism financing has been described for Australia and overseas jurisdictions such as the United Kingdom and Canada as low risk/high impact—the great majority of NPOs will never be exposed to criminal or terrorist misuse but the outcome if only a handful of NPOs are abused has the potential to be extremely harmful. Consequently, government and non-government stakeholders have asserted that recommended changes to the method by which NPOs are monitored must be proportionate to risk, although the approaches adopted have not received the same assessment.

There is little evidence the Australian non-profit sector is being abused for money laundering and terrorism financing, and the overseas evidence is not substantial either. The largest number of cases of NPO abuse has been detected in the United States, with a smaller group uncovered in the United Kingdom, Canada, Russia and Europe. There have been just two prosecuted cases in Australia—one involving charges related to money laundering and the second to the provision of assets to an entity proscribed under the purposes of the *Charter of the United Nations Act 1945* (Cth). It is hinted in parts of the literature that the problem is larger than what the published material suggests and it may well be that the lack of publicly available information on terrorism investigations, combined with possibly low detection rates, are contributory factors to the apparent dearth of substantive facts.

Nonetheless, NPOs are seen as vulnerable to criminal and terrorist abuse because of their purpose, where and how they operate, and the greater degree of self-regulation afforded to them. In minimising abuse, the sector's financial management and due diligence arrangements came under particular scrutiny based on the perception that many at-risk organisations operated without appropriate governance and financial controls. Sector surveys in the United Kingdom revealed inadequate uptake of risk and financial management strategies, which threatened funds misuse if due diligence checks were similarly deficient (Charity Commission 2009b; PKF and the Charity Finance Directors' Group 2009). It can be assumed the situation might also apply to parts of the Australian non-profit sector, although sector representatives consulted for the report insist appropriate arrangements are observed, at the very least, among larger organisations that undertake work in overseas locations.

If members of the Australian non-profit sector that are perceived at greater risk of exploitation can be isolated, then that group would comprise charities and other fundraisers (specifically those that transmit funds out of Australia and to regions which have poorer regulatory oversight), small unregulated organisations and organisations that predominantly use informal (possibly unregulated) methods of funds transfer. Added to this group would probably be NPOs that collect and distribute funds and are connected with cultural or faith-based groups. It is important to stress here that risk does not equal likelihood, particularly given sensitivities around past targeting of sector constituents, most prominently the Islamic charities. The group cited here are simply characterised by one (or more) of the factors that is accepted at promoting susceptibility.

Comparing the group nominated at greatest risk of abuse with actual cases of abuse produces a somewhat inconsistent match. Charities are the dominant, if not sole form of NPO found involved in money laundering or terrorism financing. A number of these were seemingly small and informal bodies although larger, more formal charities, particularly in the United States, were also misused. There did not appear to be any overt reliance on ARS or similar informal methods of funds transfer, or at least not from the country of origin, but complex methods of funds transfers were developed to move donations (or purported donations) around. Most notable is that almost all incidents of NPO abuse involved the use of a registered organisation that was either a sham charity or a charity that (knowingly) disbursed funds to a group that supported humanitarian endeavours alongside terrorist activities. The abuse of an unsuspecting charitable organisation does not appear to be the preferred *modus operandi*.

Numerous reviews have examined non-profit regulation and recommended how the present overly complex system can be rationalised to simplify processes and reduce administrative burden. Regulatory reform also has the potential to shape an improved approach to limiting NPO abuse. Law enforcement, academic and NPO representatives consulted for this report were in agreement that the size and nature of the sector excludes universal capture and that some at-risk or corrupted groups will inevitably escape detection. They also agreed that regulation did not need to become more stringent nor deviate too radically from the methods already used. Views diverged on what fundamental changes might be made but a system that united regulatory oversight (if that was what was required), promoted transparency and permitted flexibility was the preferred direction to take.

The establishment of a national regulator for NPOs, based on the functions of the Charity Commission for England and Wales, would serve at least two of these functions if it acted as a public register and together with standard compliance monitoring functions, was responsible for registering and endorsing tax relief and fundraising licences. The outcome would be a reduction in duplication of effort currently experienced by many in the non-profit sector and the installation of a single overseer to monitor governance and financial management. Similar entities would be subject to the same level of scrutiny and the consolidation of monitoring activities into the one body, in theory, would improve detection of, and the ability to act on, wrongdoing. A public register would complement these functions by providing the public with a list of legitimate NPOs and information on their activities and financial accountability from which decisions around organisation support can be based. As one participant to the AIC roundtables commented 'the more donors are brought into organisations which have proper processes in place, the less you have to worry about' (Roundtable participant personal communication 2009).

The installation of a national regulator, however, is not perceived as a cure-all for minimising non-profit misuse. Indeed, the research indicates that entities themselves could do more to implement the types of strategies that would alert them to suspected misuse and mitigate actual exploitation. Australia has taken the approach of publishing government-sponsored guidelines, performing sector outreach and relying upon peak body instructed codes of conduct to educate the sector on the risks and impacts of money laundering and terrorism financing, and advise on the importance of risk assessments, due diligence and strict financial controls. In the absence of targeted surveys, it is not possible to state to what extent these initiatives have been successful in the wider uptake of AML/CTF strategies, although more generalised sector surveys have shown that many NPOs, if not the majority, have not committed to implementing basic risk management strategies.

The current regime does not have an overt emphasis on AML/CTF issues, which may be interpreted as a flaw based on the findings of the FATF 2005 mutual evaluation. It may also be interpreted as a flaw if there was an elevated risk of NPO abuse in Australia; however, the available evidence suggests there is not. Further work is required to estimate the uptake of AML/CTF strategies by the non-profit sector and the factors affecting an organisation's decision-making around the adoption or disregard for such strategies.

Sector-expressed concerns about the cost of AML/CTF strategies aside, the addition of another layer of regulatory scrutiny to the *current* system may be of

limited value. Suspect donations and remitted funds involving unregistered remittance services would remain undetected but other 'funds traffic' should, by and large, be brought to AUSTRAC's attention by providers of designated services prescribed in the AML/CTF Act. Given the acknowledged difficulty in capturing a sector as large and diverse as the non-profit sector, mitigation rather than prevention of terrorist abuse may prove to be the key approach. To that end, the non-profit sector needs to develop and engage fully with appropriate risk-based management strategies and governments, and (where operational) regulatory bodies need to provide timely and actionable advice based on specific intelligence, rather than generic points of vulnerability, as to the nature and parameters of the risks to be guarded against. As has been noted:

> increasing regulatory scrutiny could both diminish charities' role in terrorist finance and allow legitimate funding of projects to proceed, which are the principal points at issue (Lee 2002: 25).

Further research

The previous discussion describes options that could be implemented to minimise misuse of Australian NPOs. To inform the operationalisation of the proposed actions identified above, research is required to address a number of information gaps. Areas for potential future research are described below.

Alternative estimates of risk

There are few published typologies of Australian non-profit misuse which affects the ability to pinpoint where specific (as opposed to generic) vulnerabilities lie. Analysis of non-compliance data, along with other relevant forms of *unpublished* information, may be used as a proxy to reveal:

- specifics around non-compliant behaviour and more serious forms of misuse;
- the extent to which cases of misuse relate to deliberate fraudulent or deceptive behaviours or judged a consequence of oversight or poor financial management practices;
- the manner in which more serious forms of misuse are handled and information communicated to other relevant regulatory partners; and
- the prevalence of misuse by charities compared with other constituents of the non-profit sector.

The role of alternative remittance services

The use of ARS is deemed a risk factor in NPO misuse but to what extent do NPOs actually depend on ARS to transmit funds? Additional enquiries could include:

- Is there a reliance on ARS by specific sections of the non-profit sectors?
- What forms of ARS (such as size of provider) are used?
- Why is ARS favoured over other forms of funds transmission?
- Are NPOs aware of money laundering and terrorism financing risks posed by ARS and what sort of background check, if any, do NPOs make when considering using a provider?
- What evidence is there for ARS misuse connected with NPOs?

Self-regulation

The non-profit sector has stressed its preference to retain at least some elements of self-regulation but there are disparate observations as to the sector's adoption of practices recommended to prevent and detect incidents of misuse. An in-depth survey of risk and financial management practices, modelled on those undertaken in the United Kingdom and in Australia, would provide a more detailed stocktake of the actual uptake of preventative and mitigation strategies and how these have been used to detect cases of misuse versus regulatory exposure. Ideally, there would be a focus on charities, with the sample comparing larger, more established organisations with those smaller charities considered at greatest risk of misuse. A related study would evaluate how effective current sector and education programs' have been in improving the sector's understanding of risks and methods to minimise risk and encouraging adoption of appropriate strategies.

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