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Submission to the House Standing Committee on Economics:

Enquiry into the Australian Charities and Not-for-Profits Commission Exposure Draft Bills

PilchConnect welcomes the opportunity to make a submission to the House Standing Committee on Economics (**the Committee**) in relation to the enquiry into the Australian Charities and Not-for-profits Commission Bill and Associated Transitional and Consequential Amendments Bill (**the Bills**).

About PilchConnect

PilchConnect is an independent community legal service providing support to not-for-profit (**NFP**) organisations. We provide free and low cost legal information, advice and training to small-to-medium 'public interest' community organisations. We do this because when organisations are well run, they are more likely to achieve their mission, and trust and confidence in the NFP sector is likely to be improved. By supporting NFPs in this way, we aim to contribute to a better civil society with more connected communities.

PilchConnect is the only specialist free legal service for NFP organisations in Australia. We fill a niche role; sitting between regulators and the private legal profession. As an independent sector-based intermediary we understand the practical constraints that small community organisations operate under, and are trusted by them to provide practical, high quality, NFP-specific legal help, or direct them to other assistance. We often help organisations work out if they really do have a legal problem, how serious it is, and what the possible next steps are. We prioritise NFPs that assist vulnerable people and in rural and regional areas.

Our submission work is based on empirical evidence and practical examples drawn from our legal inquiry, advice and case work. Given approximately half of the charities that will become registered entities under these reforms will be defined by the Bill as 'small', we believe we are uniquely placed to provide commentary on the impact the ACNC will have on the those grassroots, volunteer-reliant organisations as these form a large percentage of our client base.

Overall Comments

PilchConnect has been a strong advocate for the establishment of a national independent regulator for the NFP sector for many years. We welcomed the Government's NFP reform agenda when it was announced in the 2011/12 Budget, and have actively engaged in debates since then about the proposed ACNC legislative framework and regulatory approach. We have submitted to every major Government consultation and inquiry on NFP sector regulatory reform since PilchConnect was established in 2008 (see list of submissions at Appendix A) and in almost all of these submissions have reiterated our support for a national regulator and/or a national regulatory framework for the NFP sector.

In the context of this history of support for the ACNC, we wish to express a number of concerns about the Bills before this Committee. We have expressed many of these concerns in previous submissions and consultations (see especially our responses to the initial ACNC exposure draft and the Treasury's Review of NFP governance arrangements discussion paper, January 2012, referred to in Appendix A). We have also had the opportunity to liaise with the Australian Council of Social Services (**ACOSS**) in relation to the Bill and we are generally in strong alignment with their views, some of which are reiterated in this submission.

We acknowledge that there have been substantial improvements made to the Bills since the initial exposure draft, notably:

- ▶ A new object which recognises the diverse goals of the NFP sector.
- ▶ Better recognition of the ACNC's education and guidance functions.
- ▶ Attempts to clarify constitutional law issues.
- ▶ The insertion of simplified outlines at the beginning of each chapter.
- ▶ The ability to undertake group reporting for related entities.
- ▶ Increase in time for small registered entities to notify the Commissioner of certain events.

However in our view there are five key unresolved issues with the Bills, which we address in this submission:

- ▶ The absence of governance and external conduct standards.
- ▶ The proportionality of sanctions for small charities.
- ▶ Concerns over procedural fairness and natural justice.
- ▶ The real or perceived independence of the ACNC.
- ▶ The overall drafting approach.

This submission does not intend to comprehensively address all aspects of the Bills. The focus of our comment is particularly in relation to the impact of the proposed legislation on our core client base, small-to-medium charitable organisations.

The consultation process

First, however, we wish to make some comments on the consultation process that has led to these Bills. Since public consultations on the initial exposure draft and governance discussion paper closed in January 2012, the Government's approach has been to engage in mostly confidential 'targeted consultations' with sector representatives on aspects of the Bill. While we consider it is entirely appropriate to conduct targeted consultations with charity experts on technical areas of the Bill, in our view the approach adopted by the Treasury has lacked transparency and has impaired the ability of the sector and the Government to meaningfully work together on the development of this legislation, in the spirit of the National Compact. We are particularly concerned that small NFPs have not been adequately consulted. Many of our clients are small, volunteer-reliant charities with a deep interest in the reforms, but have been unable or ill-equipped to write a formal submission especially in the timeframes provided, and have been given very little opportunity to provide input through the targeted consultations.

While these process issues have been the source of significant frustration for the sector, we do not want to see the opportunity for this important reform fail or be further delayed.

We raise the issues below in the spirit of working towards the ACNC opening its doors on 1 October 2012. We also consider that the ACNC, once established, can play an important part in working with the Treasury and others within Government in the formulation of policy, engagement with the sector and communication of its role to the sector.

The approach to regulation

We also wish to make a comment in relation to what we believe to be the proper underlying regulatory approach for the ACNC. As noted above, approximately half of the registered entities under the reforms are likely to be within the 'small' category. Our service prioritises assistance for small, grassroots, volunteer-based associations with little or no access to legal assistance. In our experience, these organisations want to comply with legislative requirements and indeed go out of their way to attempt to understand their legal and regulatory obligations, with the view to complying.

It is from this experience that we applaud the inclusion in the new Objects of the Bill, recognition of the ACNC's role to 'support and sustain' the sector as well as to regulate it with the view to protecting public trust and confidence. It is the support, education and guidance functions of the regulator that will result in greater compliance, rather than a framework that is too heavily focused on enforcement. We appreciate the ACNC must have the ability to sanction where necessary, however our submissions are made with the view that this ought not be the only focus, and we emphasise the importance of a regime that is accessible, trusted, and that encourages compliance. These themes are evident throughout our following comments.

Key Issues

1. Governance and External Conduct Standards

We welcome the Government's decision to defer the governance and external conduct standards to enable further consultation with the sector, particularly as we had serious reservations about the approach proposed in the Treasury's earlier *Review of NFP Governance Arrangements Discussion Paper* (see our submission dated 27 January 2012).

The governance and external conduct standards are a central element to the regulatory framework of the ACNC Bill, as non-compliance or likely non-compliance with these standards triggers the exercise of key ACNC powers and imposes potentially significant obligations on the part of registered charities. Unfortunately, these standards are not yet publicly available, and are therefore unable to be scrutinised by the Committee in the current process.

Without knowing the proposed nature and scope of these standards, it is extremely difficult to properly assess the potential impact of the Bill, including its compliance burden on small volunteer-run organisations. We also note there have been no public statements by the Government that it intends to depart from the tenor of its initial (and we submit problematic) governance proposals, only that it will consult further with the sector before introducing them in regulations.

We submit the Committee's ability to properly assess the Bill will be significantly impaired without having reference to the proposed governance and external conduct standards. We urge the Committee to request further information on the Government's intentions with regard to governance and external conduct standards as part of this Committee process. We support ACOSS's recommendation that the standards in their current form be included in the Committee's inquiry.

Recommendation 1

That the Committee requests from the Treasury a copy of the governance and external conduct standards in their current form, and include these with the Bill in its inquiry.

We have further concerns stemming from the suggestion that governance and external conduct standards are to be enacted through regulations (as opposed to including 'principles-based' standards in the legislation itself). While the approach of prescribing standards in regulations is designed to ensure they are easier to update and modify as appropriate, we are concerned that there are very vague limits in the Bill as to what the governance and external conduct standards can legitimately include.

In our view, it is critical that the governance and external conduct standards strike the correct balance between promoting accountability and respecting charities' autonomy and independence. We caution against the standards becoming too prescriptive, so as to infringe on inherent freedoms of association, impairing an entity's ability to conduct its own internal affairs as it sees fit. The content of the governance and external conduct standards should be kept to the minimum necessary to afford confidence that a charity is entitled to be registered. Beyond that, charities should be free to determine how their organisation is constituted and run.

Recommendation 2

That the Bill include safeguards to ensure that any governance and external conduct standards prescribed by regulation do not unnecessarily intrude on an entity's autonomy and independence

We also note that prescribing standards in regulations reduces the level of parliamentary scrutiny and consultation they might otherwise be subjected to. While we applaud the Government's commitment to further consult with the sector before the first standards are introduced in 2013, this may not always occur in the future. As a future safeguard, we submit that the power to prescribe governance and external conduct standards should be subject to a legislative requirement to consult with the sector before any such regulations are made.

As we explained in our submission to the Treasury's earlier governance discussion paper, most charities are already required to comply with a range of governance-related obligations, including via incorporating legislation and/or common law duties, standards or requirements relating to areas of work such as housing or health, fundraising regulations, and government contracts. Given that an overarching policy aim of this reform is the reduction of red tape, it is reasonable to require extra consultative steps to be taken to ensure any governance and external conduct standards avoid duplication and/or undue regulatory burden, especially for small volunteer-run charities.

We further submit that best practice guidance materials and/or codes of conduct developed by the ACNC in collaboration with the sector should serve to guide charitable organisations on matters such as governance and should integrate with any broader legislative provisions on this topic.

Recommendation 3

That the power to prescribe governance and external conduct standards should be subject to a requirement to consult with the sector before enactment.

2. Proportionality of sanctions for small charities

The administrative penalty scheme established by Part 7-3 of the Bill creates an inflexible regulatory approach which has the potential to be disproportionate and unduly harsh, particularly for small-to-medium registered charities.

While we appreciate that the ACNC must be notified of certain matters on a timely basis to ensure the Register remains current, we submit that it ought to maintain discretion over whether it issues notices of liability for such breaches. While we note that the Bill does provide the ACNC with the ability to remit all or part of an administrative penalty once notified, it is less than ideal for the ACNC to have to notify an entity of its liability, only to subsequently remit in circumstances where, for example, the failure to notify was an oversight reasonable in the circumstances. This is also important given clause 175-70 of the Bill compels the ACNC to notify the ATO each time a notice is issued, regardless of whether the intent is to remit liability. This undermines the independence of the ACNC and this obligation should either be removed, or greater discretion should be vested in the ACNC on whether to issue a notice in the first place.

The Objects of the Bill recognise ‘the principle of proportionate regulation’, however the structure of the administrative penalty regime is such that there is strict liability for any failure to notify the Commission of certain events, or lodge documents on time. While there has been some degree of concession for small registered entities in relation to the length of time to notify the Commissioner of certain events (60 as opposed to 28 days), we submit that a discretion which allows the Commissioner to address non-compliance without a liability notification would be useful and consistent with the stated object of assisting registered entities in complying with and understanding the legislation by providing charities with guidance and education.

If the Bill were to provide the ACNC with discretion on notification of entities liable for an administrative penalty, such discretion could be accompanied by a publicly available Regulatory Guide, similar to those currently issued by ASIC, which sets out the policy and application of the ACNC’s regulatory approach.

Further, we understand that approximately half of the charities registered with ACNC would fall within the ‘small registered entity’ definition in the Bill, with many more only just over the \$250,000 revenue threshold. Given such a large proportion of the ACNC’s regulated entities will have minimal resources and typically be governed by volunteer committees or boards, this supports the argument that greater flexibility should be afforded to the ACNC in administering penalties, particularly in relation to failures to notify the Commission of certain events. At the very least, the Commissioner should be allowed to take into account mitigating circumstances and work with the sector to achieve voluntary compliance.

Example – Young People in Need

‘Young People in Need’ (a registered ACNC charity) with an annual revenue of \$300,000 operates a food bank program for homeless youth. The charity employs two staff and is run by a volunteer committee of management. Generally, they have been struggling to fill the positions as members are reluctant to be part of the committee due to concerns about the governance requirements placed on the committee. One committee member resigns from her position due to family commitments and the committee neglects to fill the vacancy immediately, instead deferring it to the next meeting in four weeks time. The next week the committee receives a notification from the ACNC, advising them that they are liable for administrative penalties (even though the ACNC intends to remit the penalty). As required, the ACNC also notifies the ATO of this breach. The group worries this means that they will lose their charity tax concessions and DGR. And if they do, they are not sure if the ACNC can help them get them back from the ATO?

Recommendation 4

That the ACNC have a level of discretion when applying administrative penalties, consistent with the Bill’s stated object of assisting registered entities in complying with and understanding obligations.

There is precedent within the Bill for providing a flexible, proportionate approach to regulation, based on the type of entity. For example, the policy decision to exempt basic religious charities from governance standards and certain reporting requirements suggests that there is scope to develop policies around the needs of a particular sub-sector. It is unfortunate that such concessions and flexibility are not considered appropriate for other sub-sectors, particularly those smaller charities that may find it difficult to comply with the additional reporting requirements contained in the Bill.

3. Procedural fairness and natural justice

The Bill does not contain reference to procedural fairness and is silent on any obligation to inform charities or request comments prior to enforcement action or formal warnings being issued.

In our submission, the Bill should include a framework for notifying registered charities of any potential enforcement action (including warnings or directions) prior to action being taken. Such a process would allow an organisation to be aware of potential adverse findings, and provide submissions in response to a notice, prior to a formal decision or warning being issued. Clause 35-10 of the Bill allows the ACNC to issue a 'show cause' notice to entities subject to potential revocation, and we submit this mechanism should extend to other adverse decision-making powers of the ACNC. Such an approach would be consistent with a key function of the ACNC – to support and work with the sector towards voluntary compliance.

In particular, Divisions 80 and 85 of the Bill provide scope for the ACNC to provide directions and formal warnings to entities in contravention of (or likely to contravene) a provision of the Bill, and for such actions to be noted on the Register in accordance with Division 40. The consequences of publishing such a warning on the Register should not be understated, particularly as charities are reliant on their public reputation and perception. A reference on the Register to a formal direction or warning issued against a charity has significant repercussions, and for this reason we submit that there ought to be a stated procedure in the Bill that accords with principles of natural justice and procedural fairness. While it may be the intent of the ACNC to engage in informal discussions with non-compliant charities prior to issuing formal warnings, the procedure ought to be recognised in legislation.

Recommendation 5

That the Bill incorporate principles of natural justice and procedural fairness prior to an adverse decision being made in relation to a registered entity.

Example – LifeSkills

LifeSkills is a company limited by guarantee and registered ACNC charity. The Directors are all volunteers and unfortunately do not have a solid understanding of their governance requirements. The ACNC believes the Directors have breached a governance standard. The Commissioner provides LifeSkills with a warning and places this notice on the Register. However after further review of submissions given to the ACNC by the Directors, the Commissioner's concerns are found to be baseless. LifeSkills' top donor sees the direction on the Register and becomes concerned about mismanagement. He decides to withdraw future funding.

We also note that clauses 165-50 and 170-25 of the Bill appear to have the effect of enforcing decisions of the ACNC, even where that decision is on appeal. It is unclear whether these provisions attempt to override the inherent jurisdiction of appellate bodies to stay a decision while the appeal is being considered, however regardless of the intent we submit the relevant appellate body should be left to determine whether to enforce or stay decisions while on appeal.

In our experience, many charities rely on their charitable status for their continued existence. Charitable status is often essential for many reasons – such as eligibility for funding, salary packaging for staff, and ability to solicit tax-deductible donations. Particularly for small charities with limited reserves, the revocation of a charity's registration while the decision is on appeal could have catastrophic impacts. Indeed, a charity could be put in a position where it cannot appeal a revocation decision in practice, because it cannot continue to operate without its registration while the appeal is determined.

Recommendation 6

That the Bill remove references to the enforcement of decisions on appeal, leaving the appellate jurisdiction with the ability to enforce or stay a decision.

4. Independence

We support the creation of a regulator that is independent to the fullest extent possible, whilst acknowledging that its centralised function in government will mean that open collaboration with other agencies will be essential. We agree with the concerns raised by ACOSS in their submission to the Committee about elements of the Bill that detract from the independence of the ACNC and the Commissioner.

As noted above, we have particular concern about the non-discretionary obligations on the ACNC to report certain events to the Commissioner of Taxation. Further, the Bill seemingly undermines the independence and authority of the Commissioner and the ACNC by blurring the lines between the jurisdictions held by each body. In particular the definition of 'recognised assessment activity' in section 55-10 creates a situation whereby the ACNC could potentially be required to take a range of actions for the purpose of enabling the ATO to carry out its compliance enforcement functions.

We submit that safeguards ought to be put in place to ensure there is proper separation of powers between the ATO and the ACNC.

Recommendation 7

That the Bill include a provision which gives discretion to the ACNC as to whether it notifies the ATO of low-risk non-compliance events (eg a failure to notify).

Further, the lack of express provision confirming the status of the ACNC's determinations of charity status also brings into question the authority of the ACNC (particularly as the ATO retains discretion around special conditions for tax concessions, which in the 2012 revised exposure draft include a definition of 'not-for-profit'). To avoid undue complexity and inconsistencies, it is imperative that the ACNC's decisions on charitable status be determinative, and that this be recognised by the ATO.

We understand that many aspects of the relationship between the ATO and the ACNC are to be dealt with in a Memorandum of Understanding (**MOU**). We note that an MOU does not have the same legal status as a legislative provision, and is not required to be developed in a transparent manner or to be a public document. In our view while it is important to ensure there are cooperative and coordinated administrative arrangements between the ATO and the ACNC, this should not be a substitute for appropriate legislative safeguards on independence.

5. The overall drafting of the legislation

Our clients are small volunteer-run NFPs. Many are already approaching us with questions and confusion about the ACNC – some are unclear as to who and what it will administer (particularly whether the ACNC will have jurisdiction to decide on tax concessions), and how transition from the ATO to the ACNC will occur.

In our training with NFPs, we encourage those staff and volunteers of organisations to try to look up the legislation themselves if necessary, to get familiar with it, to understand the implications for their own organisations. We do this because we want to improve legal literacy within the NFP sector, especially as many NFPs cannot afford to pay for legal advice. Our experience is that the vast majority of NFPs we assist genuinely want to understand and comply with their legal and regulatory obligations, albeit sometimes requiring help to do so.

In this context, we are disappointed that the language of the Bill uses unfamiliar terms that will render the legislation inaccessible to many readers without legal training. Key concepts in the Bill, such as 'registered entity', 'responsible entity' and 'federally regulated entity', are likely to cause significant confusion within the sector. We have concerns that the inaccessibility of the legislation will weaken the sector's confidence in, and ability to connect with, the ACNC.

In our view, a volunteer committee member of a small charity is unlikely to identify that he or she is a 'responsible entity' of a 'registered entity' under the Bill, for instance. We support the recommendation made by ACOSS to replace the language of 'responsible entity' with 'governing body' where relevant throughout the Bill. We also suggest the definition of 'director' should be amended to include reference to a 'member of a committee of management' for incorporated groups, as well as 'director of a company'. In our experience, the former term is much more commonly used by incorporated associations (at least in Victoria), and the majority of incorporated NFPs in Australia are associations incorporated under state or territory legislation.

Recommendation 8

That the language of the Bill be re-considered in the interests of maximizing its accessibility to a non-legal audience of staff, volunteers and others involved in charities. In particular:

- *the term 'responsible entity' should be replaced with 'governing body' where appropriate throughout the Bill*
- *the term 'director' should include reference to a 'member of the committee of management' as well as to the director of a company, at para (a).*

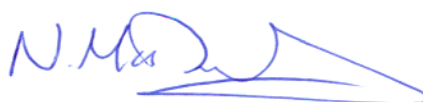
Conclusion

Thank you for the opportunity to contribute to the Committee's consideration of the Bills. We would be happy to elaborate on any of the issues raised in this submission on request.

Yours sincerely,



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Appendix A: Previous PilchConnect submissions

Along with many other NFPs, PilchConnect has contributed a significant amount of its limited resources to preparing submissions on NFP regulatory reform. Since PilchConnect established in 2008 we have made 16 public submissions to Federal Government inquiries. We have done this because we believe regulatory reforms will help prevent many of the common issues that NFPs currently bring to us.

PilchConnect recent submissions	
2012: Treasury Consultation Paper - Revised Exposure Draft regarding special conditions for tax concession entities (including the 'in Australia' conditions).	http://www.pilch.org.au/federalreform/#1
2012 The Australian Charities and Not-for-profits Commission - Implementation design	http://www.pilch.org.au/acnc/#1
2012 Charitable Fundraising Regulation Reform Discussion Paper	http://www.pilch.org.au/fundraisingreform/
2012: Treasury Consultation Paper - Review of not-for-profit governance arrangements	http://www.pilch.org.au/acnc/#3
2012: The Treasury Consultation on the Exposure Draft of legislation to establish the Australian Charities and Not-for-profits Commission	http://www.pilch.org.au/acnc/#2
2011: The Treasury Consultation Paper on a statutory definition of charity	http://www.pilch.org.au/acnc/#4
2011: Treasury Consultation Paper - Scoping study for a national not-for-profit regulator	http://www.pilch.org.au/acnc/#5
2011: The Treasury Consultation on the Exposure Draft of legislation to restate the 'in Australia' special conditions for tax concessions entities.	http://www.pilch.org.au/federalreform/#7
2011: The Treasury Consultation Paper on Better Targeting of NFP Tax Concessions.	http://www.pilch.org.au/taxreform/#4
2010: ASIC Consultation Paper on Related Party Transactions	http://www.pilch.org.au/clgreform/#1
2010: Submission to the Commonwealth Treasury — reforms to company limited by guarantee reporting requirements	http://www.pilch.org.au/clgreform/#2
2010: Submission to Senate Economics Legislation Committee — Tax Laws Amendment (Public Benefit Test) Bill 2010	http://www.pilch.org.au/taxreform/#5
2009: Further Submission to Productivity Commission, — Draft Research report, 'Contribution of the Not-for-profit-Sector'	http://www.pilch.org.au/federalreform/#8
2009: Initial submission to Productivity Commission — Issues paper, 'Contribution of the Not-for-profit-Sector'	http://www.pilch.org.au/federalreform/#8
2008: Submission to Henry Tax Review — 'Removing complexity, adding coherence: A proper framework for concessional tax treatment of charities and not-for-profit entities'	http://www.pilch.org.au/federalreform/#10
2008: Submission to Senate Economics Committee — 'Time for underpinning: a national regulatory approach for the not-for-profit sector', Inquiry into Disclosure regimes of Charities and Not-for-profit Organisations	http://www.pilch.org.au/federalreform/#11