

28 February 2018

Mr Murray Crowe
Individuals and Indirect Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

via email to ACNCReview@treasury.gov.au

Dear Mr Crowe

Review of Australian Charities and Not-for-profits Commission Legislation

The Australian Institute of Company Directors (**AICD**) welcomes the opportunity to provide a submission to the Treasury's consultation on the Review of Australian Charities and Not-for-profits Commission (**ACNC**) legislation (**consultation paper**).

The AICD is committed to excellence in governance. We make a positive impact on society and the economy through governance education, director education, director development and advocacy. Our membership of more than 41,000 includes directors and senior leaders from business, government and the not-for-profit (**NFP**) sectors.

The NFP sector is a major focus of the AICD's work; we estimate that two thirds of our membership are involved in the work of an NFP in some way, many of them making contributions as directors on a voluntary basis. The AICD is committed to advocating for a fit-for-purpose regulatory regime for the NFP sector that is streamlined, national and will support good governance in this important sector.

Summary of position

The ACNC is a critical component of a fit-for-purpose regulatory framework for the NFP sector. The AICD supports the existence of a national regulator for charities and congratulates the ACNC and its staff on their work since 2013.

Broadly speaking, the AICD does not believe that there is any need for major revision to the ACNC's legislation, purpose or activities. However, there are some refinements that could be made to the framework to improve its operation such as:

- Amending the *Australian Charities and Not-for-profits Commission Act 2013* (Cth) (**ACNC Act**) to prioritise the ACNC's first object as its dominant object;
- Undertaking a review of the reporting framework (such as revising reporting tiers and the use of special purpose financial statements);
- Increasing disclosure of related party transactions;

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- Provide the ACNC Commissioner with the ability to disclose the context and rationale for their enforcement decisions; and
- Undertaking a review of the ACNC Register to ensure that it meets the needs of users.

Our detailed responses to the consultation questions are included in **Attachment A**.

In addition to our responses to the specific questions raised in the review, the AICD has set out its recommendations on engagement and regulation of the not-for-profit sector (including charities) in our April 2017 report *Governance of the Nation: A Blueprint for Growth*.

Most relevantly, the AICD recommended:

- A fit-for-purpose regulatory environment with nationally consistent definitions and reporting systems and less duplication; and
- Freedom of voice for funded NFPs and their boards.

We hope our comments will be of assistance to you. Should you wish to discuss any aspect of this submission, please contact our Senior Policy Adviser, Lucas Ryan via lryan@aicd.com.au or (02) 8248 6671.

Yours sincerely



LOUISE PETSCHLER
General Manager, Advocacy

ATTACHMENT A: Responses to consultation questions

Question 1

Are the objects of the ACNC Act still contemporary?

The AICD considers that the objects of the ACNC Act remain appropriate and do not require major revision. The AICD notes the extensive consultation undertaken on these objects and the strong endorsement they received, particularly concerning supporting the sector (15-5(1)(b)) and reducing red tape (15-1(1)(c)).

However, there may be merit in giving consideration to differential weightings for the objects.

As the national regulator of charities, the AICD considers that the object of maintaining, protecting and enhancing public trust and confidence in the sector (15-5(1)(a)) should be the ACNC's primary objective.

The AICD considers that the second and third objectives are intended either to:

- Be of secondary priority to the first objective;
- Support the delivery of the first objective; or
- Flow from the achievement of the first objective.

There may be times that the ACNC's first objective conflicts with its second or third objective. For example, requiring a charity to provide information about its activities (under the ACNC's information gathering powers) might create additional regulatory burden for the charity, but is necessary in pursuit of the first objective. This may be perceived as a conflict between objects, but clearly the first object should take precedence in such situations.

Where an entity is engaged in serious misconduct such as to threaten the public's trust in the sector, the primary focus of the regulator must be on taking action to protect the public's trust through addressing misconduct. This suggests that the ACNC's first purpose is its dominant purpose.

The AICD recommends that the ACNC Act be amended to stipulate that its first object is the primary object of the ACNC.

Proposed additional objects

The AICD notes the proposal from the ACNC to include two new objects:

- To promote the effective use of the resources of not-for-profit entities; and
- To enhance the accountability of not-for-profit entities to donors, beneficiaries and the public

These additional objects are not required in the AICD's view.

The AICD considers that strategies and decisions on efficiency, and determining the measures used to do this, should be left to individual charities. Charities (like non-charitable companies) should be able to determine their own measures of efficient performance and to be evaluated against them by their stakeholders. We would not view the collection of performance data by the ACNC as necessary or beneficial.

The existing framework already enables appropriate regulatory oversight and also allows members of the public to access high-level information about a charity's operations and finances.

The ACNC provides information about charities to the public to demonstrate that they are registered, legitimate operations and that they are pursuing a charitable purpose. The AICD considers this scope of information appropriate.

Question 2

Are there gaps in the current regulatory framework that prevent the objects of the Act being met?

Application of directors' duties

The ACNC's governance standards, under Division 45.25(2) of the *Australian Charities and Not-for-profits Commission Regulation 2012 (Regulations)*, establishes a system of directors' duties modelled on those set out in the *Corporations Act 2001 (Cth) (Corporations Act)*.

However, formulation of the Regulations requires the registered entity (**charity**) to "take reasonable steps to ensure that its responsible entities are subject to, and comply with..." these duties. Responsible entities (**directors**) are not individually subject to any duties under the Regulations (although, if a charity is incorporated under state or territory legislation rather than the Corporations Act, similar direct duties may be applied through these statutes).

As a matter of principle, the AICD would be supportive of charity directors' duties being expressed and applied as clear individual duties with consistent and clear expectations on charities of all types, within the regulatory framework of the ACNC. This should be tempered by the understanding that many NFP directors give their time and expertise on a voluntary basis and measures which might be a disincentive to this should be avoided.

We understand that constitutional limitations impact the framing of the current Act and approach. We also note that imposing Corporations Act duties and civil penalties would not be consistent with the policy framework for charities and ACNC regulation.

Recognising this, the AICD recommends that:

- the government provide clarity whether it is possible for the Regulations to impose directors' duties on directors individually and, if not, investigate possibility for referral of powers to achieve this; and
- the ACNC undertake further education on governance standard five and its expectation of directors' duties, including considering more comprehensive guidance for registered entities on compliance with 'reasonable steps' requirements.

Basic religious charities

The AICD notes the exemption of 'basic religious charities' (**BRC**) defined in Division 60-60 of the ACNC Act from certain regulatory obligations, including the governance standards and financial reporting requirements.

Many BRCs control significant charitable assets and their exclusion from the reporting framework appears to be at odds with the ACNC's objective to provide appropriate accountability and transparency of all registered charities. The absence of reporting from

BRCs also diminishes the valuable aggregate data about the sector provided through the *Australian Charities Report*.

The AICD considers this to be a gap in the regulatory framework and recommends that the government review this exemption.

Question 3

Should the regulatory framework be extended beyond just registered charities to cover other classes of not-for-profits?

In principle, the AICD supports the extension of the ACNC's remit to include NFP entities. However, whether this is acceptable in practice will depend on what aspects of the framework are applied and in what manner.

Charities are distinct from NFPs because of the additional benefits (such as tax concessions) that come with registration as a charity. The obligations to which charities are subject are intended to be proportionate to the benefits they receive. The same regulatory framework, if applied to NFPs on a compulsory basis, may not be proportionate or appropriate because they would not be commensurate with the benefits.

However, there are a number of benefits that may be realised for NFPs through extending the ACNC's regulatory remit to include them on a voluntary basis, for example:

- Complying with the ACNC's reporting and other regulatory requirements may promote good governance and transparency in the NFP sector;
- Improved data could be collected about the broader NFP sector through reporting by these entities;
- Appearing on the ACNC Register may be beneficial for some NFPs;
- Lighter-touch regulatory requirements compared to corporations legislation may be more appropriate for NFPs that are companies currently regulated under that regime; and
- Being registered with the ACNC (and subject to its regulatory framework) may streamline regulatory requirements (such as accessing fundraising licenses and participating in the 'report once, use often' regime).

The AICD would support an extension on a voluntary basis, but strongly recommends that further consultation be extended on the practical implications of such a model. The AICD does not support the extension of the ACNC's regulatory framework to NFPs on a compulsory basis.

Question 4

What activities or behaviours by charities and not-for-profits have the greatest ability to erode public trust and confidence in the sector?

The AICD considers that there are three key behaviours by charities and NFPs that have the greatest effect on public trust and confidence in the sector:

- 1) Misuse of charitable resources for unlawful purposes;
- 2) Application of charitable resources for private benefit; and
- 3) Poor practice and misconduct in fundraising.

Unlawful activity by charities, particularly those in receipt of public donations or that work with vulnerable people, erodes public trust and confidence in the sector. Although instances of

such misconduct are relatively rare, they have the ability to damage the reputation of all charities.

Private benefit strikes at the heart of charitable enterprise. The fundamental assumption that underpins public trust in charities is that they are run by good people who are undertaking good works. Where private benefit exists, there has been a direct deceit of public trust and this should be responded to by the regulator on a zero-tolerance basis.

Poor practice and misconduct in fundraising also poses significant threats to public trust and confidence. The use of third party, for-profit fundraisers has attracted significant media attention recently and in some cases reports suggest an unconscionable minority of monies collected is ultimately applied to a charitable purpose. This too undermines the trust of the public who assume that donations will be applied by a charity in good faith and towards a charitable purpose.

Question 5

Is there sufficient transparency to inform the ACNC and the public more broadly that funds are being used for the purpose they are being given?

The AICD considers that the ACNC's reporting framework broadly provides sufficient transparency about the operations and financial activities of charities. However, there are some areas that warrant further attention to improve its application, utility and fairness.

Thresholds for NFP financial reporting

The AICD considers that the reporting thresholds set out under the ACNC Act to be too low and not subject to objective criteria on how they are set or on what basis they might be revised.

The Australian Accounting Standards Board (**AASB**) Research Report 5 *Financial Reporting Requirements Applicable to Charities – October 2017* revealed that reporting thresholds across the NFP sector were highly variable and not underscored by consistent rationale.

The policy rationale for the tiered reporting structure is to ensure that potential users of financial reports have access to the information they need. This is balanced by a consideration of the cost of preparing financial reports and having them reviewed or audited.

The AICD considers it unlikely that there is significant user interest in audited or reviewed financial reports for charities with revenues less than \$1 million. The cost to charities in preparing these reports will likely not be commensurate with the benefit to users.

The AICD recommends that a review be undertaken of existing reporting thresholds involving international comparisons, an assessment of user needs, use of objective criteria and an evaluation of the costs associated with applying relevant accounting standards and undertaking an audit or review. Consideration should also be given to whether such amendments should be made across other legislation (such as the Corporations Act) to ensure consistency.

It may also be beneficial to define reporting thresholds in the Regulations rather than the ACNC Act so that they can be reviewed more regularly and adjusted if required.

Improving reporting quality

The ACNC has reported a significant error rate in charities' annual financial reports (**AFR**). In a review conducted by the ACNC of 1,935 charities (who collectively control 80 per cent of the sector's total assets or revenue), material errors were discovered in 11 per cent of AFRs. In a further review of AFRs from charities outside this band, material errors were detected in 68 out of 151 (45 per cent) sample reports.

This is a materially significant error rate and pollutes the quality of data available about the sector available in aggregate, such as through the *Australian Charities Report*, as well as undermining the reliability of data available on the ACNC Register.

The ACNC has reported that most of the errors it has detected come from charities that prepare special purpose financial reports. The AASB has also issued research showing that special purpose financial reports have produced 'variable' reporting¹.

The AICD suggests that policy makers consider sector and stakeholder (including the AASB) consultation on the financial reporting requirements for Australian charities and options to improve quality. Minimising the regulatory burden for charities should be a continuing priority in any consideration of reporting changes.

Related party transactions

As outlined in response to **Question 4**, the AICD considers that public trust and confidence in the sector can be eroded by the application of charitable resources for private benefit. One of the common ways through which private benefit occurs is through improper related party transactions. Charities that self-assess as non-reporting entities are not subject to mandatory reporting requirements for related party disclosures in the financial report through AASB 124 *Related Party Disclosure*. Generally, charities that self-assess as non-reporting entities and prepare special purpose financial reports do not voluntarily adopt this related party standard.

The AICD would support amendment to the regulations to require all charities to comply with AASB 124 and disclose related party transactions, regardless of whether or not the charity is a reporting entity. This feature is already in place for other accounting standards, such as compliance with AASB 101 *Presentation of financial statements*. For small charities that do not prepare financial reports, we recommend that a facility for disclosing related party transactions should be provided in the ACNC Annual Information Statement.

Question 5 and 6

Have the risks of misconduct by charities and not-for-profits, or those that work with them, been appropriately addressed by the ACNC legislation and the establishment of the ACNC?

Are the powers of the ACNC Commissioner the right powers to address the risk of misconduct by charities and not-for-profits, or those that work with them, so as to maintain the public's trust and confidence? Is greater transparency required and would additional powers be appropriate?

On balance, the AICD is satisfied that the range of powers available to the ACNC enable it to effectively address misconduct by charities.

¹ A recent AASB Discussion Paper (*Improving Financial Reporting for Australian Charities*) identifies issues of inconsistencies between charity financial reports and notes the significant judgement required in determining the type of reporting to prepare.

However, there are some aspects of the legislation that could be refined to better equip the ACNC to ensure public trust and confidence in the charity sector, and to make the regime more consistent with other regulatory frameworks.

Secrecy provisions

In order to ensure the trust and confidence of the sector, the ACNC must not only undertake regulatory action to address misconduct, but it must also be able to communicate to the public what the misconduct was and how it has been addressed.

At present, the secrecy provisions set out under Division 150-15 of the ACNC Act prevent the ACNC from being able to disclose the context or rationale for its enforcement decisions. Because of this, it is impossible for the public to know (except where the limited exemptions to those provisions apply) what the ACNC has done to address misconduct. The secrecy provisions also limit the opportunity for the sector to draw on enforcement decisions to improve practice and reduce risks as part of ongoing performance improvement.

The AICD recommends that once an enforcement decision has been finalised by the ACNC (subject to any reviews or appeals), its outcome and rationale should be disclosed.

However, the AICD would not be supportive of the ACNC publicly disclosing that it is undertaking an investigation prior to making a determination. There is a risk that a charity's reputation may be damaged unnecessarily (and by extension, that public trust and confidence in the sector eroded) through disclosures of impending or current investigations.

We appreciate, however, that there may be extraordinary circumstances where a concern is of sufficient seriousness that it is in the public interest to know that an investigation is underway. One option that could be the subject of more detailed sector consultation could be giving the ACNC power to make such a disclosure with court approval, subject to materiality tests and where it can prove that the disclosure is in the public interest. We stress that the risks of this approach would be substantial to reputation, resources and natural justice, and would strongly recommend detailed consultation with the sector on any proposal to extend disclosures in this way.

Flexibility of the ACNC Register

The ACNC Act and Regulations are highly prescriptive about the representation of information on the ACNC Register. While it is appropriate to ensure a baseline and consistent representation of information about all registered charities, it would be beneficial if there was greater flexibility about the types of information that can be provided.

Some information that the ACNC already has access to and which would be valuable to display on the ACNC Register is not presented. For example, it is not possible to display a charity's charitable purpose because of the restrictive legislation, but this would be valuable information for users and could be done without additional regulatory burden for charities.

Other information which is not collected by the ACNC may also be used to enhance the representation of a charity on the ACNC Register. For example, a charity might want to include a blurb about itself to explain the context for the other information represented on the register. At present, two organisations that are vastly different in character might be represented almost identically on the ACNC Register. Any such information should be collected and displayed on a voluntary basis so as not to create additional regulatory burden or disadvantage charities that do not record this information.

The AICD recommends that the regulations governing the representation of information on the ACNC register be the subject of consultation and review by the government.

Disqualified persons register

The AICD notes the recommendation of the ACNC in its submission to this review to include the date of birth of directors to the 'Disqualified persons register'.

Making private data (such as dates of birth) available about individuals places them at significant privacy risk including cyber attacks and identify theft.

The AICD recognises that there is a case for access to personal information of company directors in circumstances where there is a public interest justification. Examples could include access by lawyers for legal notices, or access for journalists for public interest journalism.

The AICD recommends that the government investigate ways to enable access to personal information in relevant circumstances, for example through application to the ACNC for defined or public interest purposes. The AICD supports the introduction of 'Director Identification Numbers', proposed in anti-phoenixing reviews, and encourages the government to consider extension of this concept to the charitable sector if appropriate.

Question 8

Has the ACNC legislation been successful in reducing any duplicative reporting burden on charities? What opportunities exist to further reduce regulatory burden?

The AICD congratulates the ACNC on its work in reducing red tape for charities. The ACNC's progress towards addressing duplicative and unnecessarily burdensome regulatory obligations has been impressive, especially recognising the pressure of establishing a new regulatory regime and the protracted uncertainty under which it operated.

Progress on implementing the 'report once, use often' framework and common audit thresholds for incorporated associations has significantly reduced red tape for charities incorporated under this structure in participating jurisdictions. However, harmonisation of reporting and licensing requirements for fundraising continue to lag. The AICD acknowledges that this is not the fault of the ACNC as significant intergovernmental cooperation is required, but recommends that further work be done in this area.

Although much can and has been done by the ACNC to reduce red tape for charities, other governments and individual government agencies must be willing to come to the table to give effect to change. While advocacy by the ACNC will continue to bring states and territories on board over time, there is still work to be done at the Commonwealth level to lead the way in relieving regulatory burden.

The AICD has been a vocal advocate for reform to the fundraising environment through the #fixfundraising campaign, which recommends that the regulation of fundraising be brought under the Australian Consumer Law (**ACL**). Amending the ACL to ensure its application to fundraising is clear and broad, together with the repeal of out-of-date state and territory regulatory regimes, would create a nationally-consistent and fit-for-purpose regulatory regime for fundraising.

In a superseded version of the Commonwealth Grant Guidelines (**CGG**), Australian Government agencies that funded charities were prevented from being able to request

information that had already been provided to the ACNC. This was removed in a subsequent amendment.

Much of the duplicative reporting that charities experience is as a result of acquittals both between and within different government agencies. Significant reductions could be made to red tape in this regard through appropriate amendments to the CGG, requiring the adoption of the 'report once, use often' framework by Australian Government grant makers.

The AICD recommends that the CGG be amended to prevent Australian Government agencies from requesting information from charities as part of funding acquittals if this information has already been provided to the ACNC.

Question 9

Has the ACNC legislation and efforts of the ACNC over the first five years struck the right balance between supporting charities to do the right thing and deterring or dealing with misconduct?

The AICD believes that the ACNC legislation and its implementation by the ACNC has struck an appropriate balance between being a supportive regulator and also in taking action to address misconduct. The AICD also acknowledges the significance of this achievement in the context of the uncertain operational environment in which the ACNC existed during much of its establishment phase.

The ACNC's focus on guidance and education in the early years of its operation was welcome and appropriate, and worthy of the commendation it has received. The AICD congratulates the ACNC on its commitment to and delivery of meaningful stakeholder engagement and consultation to support this work.

Its nation-wide public engagement programs (such as 'AskACNC'), its regular stakeholder reference meetings (such as its 'Sector User Group' and 'Professional User Group'), commitment to regular and best practice consultation with the sector (such as on the development of 'Commissioners Interpretation Statements') and its extensive suite of high-quality guidance and education resources have underscored its efforts in this regard.

Towards the end of its first five years, the ACNC has also become more active in utilising its compliance function, including issuing penalty notices and exercising its enforcement powers. The ACNC's compliance reports have been a valuable demonstration of its work in this regard, though there is opportunity to enhance its capacity through the refinements recommended in this submission.

The AICD has enjoyed a strong working relationship with the ACNC over the past five years, founded on our shared belief in the importance of good governance in the charity sector. We look forward to further opportunities to partner on improving governance practice among charities and the broader NFP sector in the future.