AUSTRALIAN INSTITUTE
of COMPANY DIRECTORS

Submission by

The Australian Institute of Company Directors

to

Federal Treasury

in response to the

Draft Charities and Not-for-profits Commission Bill 2012

27 January 2012

Introduction

This submission includes comments by the Australian Institute of Company Directors (Company Directors) in response to the Draft Charities and Not-for-profits Commission Bill 2012 (the Draft Bill), released on 9 December 2011. Through providing our views we hope to assist Treasury and the Federal Government with their deliberations.

About Company Directors

Company Directors is the second largest member-based director association worldwide, with over 30,000 individual members from a wide range of corporations: publicly-listed companies, private companies, not-for-profit organizations (NFPs), charities, and government and semi-government bodies. As the principal professional body representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current director issues in policy debates.

The NFP sector has been a particular area of focus for Company Directors. Our activities have included tailored educational services, events, published materials, research, and facilitation of dialogue among members and others on NFP issues. We have participated in NFP policy reform discussions and lodged various submissions, for which we have had input from our membership, including our Policy Committees and NFP Steering Committee.

Company Directors has a significant interest in the national NFP reforms currently being progressed. Our Director Social Impact 2011 suggests that over half of our members currently hold at least one NFP directorship, in addition to other members who are or have been directly involved in the governance of one or more NFP entities.[1]

More time is required for stakeholders to consider the Draft Bill

While Company Directors has been a strong supporter of the Federal Government's vision for an efficient, transparent, productive and vibrant NFP Sector, we must begin by expressing our extreme disappointment regarding the continued practice of Federal Treasury and the Federal Government to engage in consultations over the Christmas and New Years' period, notwithstanding past pleas from Company Directors and others for this practice to stop. We do not regard relatively short consultations over this period as representing genuine attempts at seeking feedback.

The approach to the current review, along with a number of others currently underway by Federal Treasury and others, represents very poor regulatory

[1] Company Directors, *Directors Social Impact Study 2011*, at page 5.

review practice and must cease. Our concerns have been set out in letters to Federal Government Treasury Ministers.[2]

We acknowledge that, subsequent to our letters, a one week extension of time was given in order for interested parties to make submissions in respect of this consultation. While this extension was welcomed, there has still been insufficient time for us to provide comprehensive responses to the Draft Bill, and there are parts of the Draft Bill that we have not had an opportunity to consider at all.

More detailed consultation is required on the Draft Bill, as well as a more holistic approach to a variety of issues that are being discussed in the various NFP consultations that have recently taken place, are currently underway and are foreshadowed to occur in the near future. While NFP reforms should not be unduly delayed, equally these reforms should not be progressed without proper and thoughtful consideration of the relevant issues. Based on current NFP consultations, we believe it would be preferable to extend the current 1 July deadline for the establishment of the ACNC and associated reforms, until after full and proper consultation has taken place and moves to reduce red tape are more advanced (see comments below).

This submission should be read in conjunction with our responses to:

- the Consultation Paper "Scoping study for a national not-for-profit regulator", released on 21 January 2011;
- the Consultation Paper "A Definition of Charity", released on 28 October 2011; and
- The Consultation Paper entitled "Review of not-for-profit governance arrangements", released on 8 December 2011.

General Comments

We offer the following general comments on the Draft Bill.

- Much of what is being proposed appears to have been written largely with charities in mind. While we understand that the initial focus of the ACNC will be on charities, we would have preferred to see a framework that better catered for the wide range of NFPs that exist, particularly those individual NFPs that are not economically significant.

- The governance requirements that are proposed for NFPs are of particular interest to Company Directors. There is reference in the Draft Bill (section 5-10(1A)) to the "governance section" of the Bill, but no such section is apparent. There is a section in the Draft Explanatory Materials on Governance (Section 4), however this is very thin on detail. The absence of detail in this area, and the various other yet-to-be drafted

[2] These letters are available at http://www.companydirectors.com.au/Director-Resource-Centre/Policy-on-director-issues/Policy-Submissions/2011/Letters-to-Government-Ministers-on-Consultation-Issue.

sections of the Draft Bill, make it very difficult for Company Directors to provide detailed feedback.

- It is important to remain mindful that present indications are that it is likely the current set of proposed reforms will add to the regulatory burden for charities in the short and medium term, as there is still a process of negotiation that needs to take place with state governments, as well as various agencies and bodies that impose governance and reporting requirements on charities. There are also such requirements imposed on NFPs by various industry regulators (e.g. in the insurance sector). There is an argument that for the objectives of the proposed reforms to be achieved, new requirements should not be phased in until sufficient agreement has been reached with others imposing governance and reporting requirements on charities. Otherwise charities will be subjected to further unjustified and costly duplication, which works against a key objective of the proposed reforms.

The duties of responsible individuals should be similar to those owed by directors of companies limited by guarantee

The Draft Explanatory Materials (Paragraph 1.156) notes that a responsible individual (director) must "exercise the same degree of care, diligence and skill that a prudent individual would exercise in managing the affairs of others". This would seem to imply a higher "trustee" standard of care rather than a fiduciary duty to the entity or the duty of care and diligence in section 180(1) of the Corporations Act.[3] We do not support this approach and refer the reader to our submission in response to the Consultation Paper entitled "Review of not-for-profit governance arrangements", released on 8 December 2011, where we set out our views on the duties which should exist for responsible individuals/directors.

The proposed powers of the ACNC Commissioner to give directions are excessive and without appropriate safeguards

Section 140-10 of the Draft Bill gives the Commissioner power for a range of expansive directions to a registered entity where, for example, the Commissioner is of the view that a registered entity has contravened or may contravene a provision of the Act or any other Australian law that relates to the objects of the Act. We are of the view that the proposed powers do not have appropriate safeguards attached and may unduly interfere with the ability of charities (and eventually other NFP entities) to run their organisations. This is particularly the case, where a registered entity disputes the ACNC's view that the registered entity has contravened the Act or the registered entity takes the view that it is running its affairs in a financially sound manner.

Pursuant to section 140 -15, the Commissioner has the power to give directions to make the registered entity comply with the law. However, the provisions fail

[3] The care and diligence duty in section 180 of the Corporations Act provides that a director must exercise their powers and discharge their duties with the degree of care and diligence that a "reasonable person" would exercise "in the corporation's circumstances" and "occupied the office held by, and had the same responsibilities within the corporation as the director or officer".

to take into account the fact that a registered entity and the ACNC may have different interpretations as to the meaning of the law. In the event that a registered entity disagrees with the ACNC's view of the law, the registered entity should have a mechanism available to them by which they can appeal the direction to an independent body or Court.

The directions the Commissioner can give include preventing a person from taking part in the management of an organisation. In the same way that ASIC does not have an unfettered right to disqualify a director of a corporation, the ACNC's powers should be similarly constrained. The power to remove an individual from being involved in the management of an organisation has serious consequences for the individual involved and should only occur pursuant to a Court order and where appropriate safeguards and appeal rights are in place.

We are also concerned that if the Commissioner is of the view that a registered entity has contravened the Act (even if the registered entity has not), the Commissioner can step in and prevent the entity from entering into commercial transactions. We are of the view that these powers are excessive, do not have appropriate safeguards attached to them and are not limited to only the most serious contraventions of the Act. As currently drafted, a minor or technical breach of the Act would allow the Commissioner to step in, remove responsible individuals from their positions and essentially make business judgments on behalf of the organisation. We are of the view that these powers are unnecessarily draconian and should be reconsidered.

A "fit and proper person" test would be inappropriate for the vast majority of NFPs

One of the pieces of information that the Commissioner is required to maintain on a "register" is directors' qualifications (Draft Bill, Part 4 section 100-10). There are also provisions empowering the Commission to "exclude" directors by way of Commission direction (see above). When read in conjunction with the Consultation Paper entitled "Review of not-for-profit governance arrangements" (released on 8 December 2011), there appears to be the prospect of moving towards a "fit and proper person" regime.

As noted in our submission dated 18 February 2011 in response to the Consultation Paper titled "Scoping study for a national not-for-profit regulator", the regulatory and compliance imposition associated with ensuring compliance with a "fit and proper person" test is considerable. It would be unduly onerous for many small NFPs. We note that even major public listed entities, other than those regulated by APRA, are not subject to such a test.

Many NFPs currently struggle to attract experienced directors to join their boards, and the application of a "fit and proper person" test, in the context of qualifications, would further inhibit their ability to attract directors, and reduce the available pool of suitable directors.

The "reporting entity" concept should be retained in relation to annual financial statements

The Draft Bill (Sub-Division 55-B) could be read as suggesting that all Medium and Large registered entities should prepare general purpose financial statements (GPFRs). We note that many such NFPs are currently not classified as "reporting entities". We further note that attempts have been made by the Australian Accounting Standards Board to expand the application of accounting standards to those NFPs that to date have been regarded as "non-reporting entities" under the "reporting entity" concept.

Company Directors would strongly oppose any moves to require all Medium and Large registered entities to prepare GPFRs. We believe that the "reporting entity" concept has been an important part of Australia's reporting framework, particularly following the introduction of IFRS in Australia, and that similar relief should continue to be in place. In our experience there are many NFPs for which GPFRs are unnecessary and costly, even with reduced reporting rules.

The proposed audit requirements require modification

We note that Medium registered entities can elect to either be audited or reviewed (section 55-35). Many will already have audits, sometimes with their constitutions requiring this. The Draft Bill (section 55-40) requires an auditor to be a registered company auditor but a reviewer to only hold a practising certificate. Currently, many NFPs are audited by persons who would qualify as reviewers but are not registered company auditors. It seems harsh and unnecessary to require those NFPs to, in effect, either change their auditor to a registered company auditor, or to change their constitution to require only a review rather than an audit. We believe it should remain a matter for each individual charity whether it engages a registered company auditor as its auditor. We make the following additional observations.

- There is a shortage of registered company auditors, and charities and other NFPs will need to compete with the for-profit sector for this resource. Attempts to force common reporting periods will further exacerbate this problem (see below).

- It could well be that an auditor who is not a registered company auditor, but who for instance has a significant portfolio of NFP audit clients and is experienced in the nuances of NFP finance, produces the same (or better) outcome than a registered company auditor. The mandated use of a registered company auditor is likely to add significantly to the cost of an audit for many charities, and may have the perverse effect of introducing a bias towards reviews over audits.

We further note that the requirement that an auditor's report describe "any defect or irregularity in the financial report" (see Section 55-60(4)) is too broad and unnecessary given existing auditing standards and the other requirements in the Draft Bill.

Registered entities should not be forced to have the same closing date for annual financial reports

We note it is proposed that registered entities must give their financial report to the Commissioner no later than 31 October in the following financial year (section 55-10) and that the Commissioner *may* allow an entity to adopt an accounting period on a day other than 30 June if the registered entity applies to the Commissioner in the approved form (section 55-90(1)). We would be concerned if this means that charities will be forced to have a financial year ending on 30 June. We note that such a requirement would impose unnecessary costs on many charities and make it more expensive for them to obtain accounting and auditing services given the concentration of demand for such services at that time.

The tiers for Small, Medium and Large registered entities are too low

We note that the Draft Bill categorises Small, Medium and Large registered entities as follows.

> **210-10 Small, medium and large registered entities**
> (1) A registered entity is a small registered entity in a particular financial year if:
> (a) it is not a deductible gift recipient at any time during the financial year; and
> (b) the revenue of the registered entity for the financial year is less than $250,000, or any other amount prescribed by the regulations for the purposes of this paragraph.
> (2) A registered entity is a medium registered entity in a particular financial year if:
> (a) it is not a small registered entity in the financial year; and
> (b) the revenue of the registered entity for the financial year is less than $1,000,000, or any other amount prescribed by the regulations for the purposes of this paragraph.
> (3) A registered entity is a large registered entity in a particular financial year if it is not a small registered entity or a medium registered entity in the financial year.

We would have liked to have seen a discussion around the appropriateness of these thresholds and their regulatory impact. While the Corporations Act (section 285A) contains similar thresholds for companies limited by guarantee, we note that the Draft Bill is intended, in time, to apply to a much larger number of entities. In our view these thresholds are too low. We consider it would be much more appropriate, for example, for the upper revenue threshold for a Small registered entity to be $500,000, and the upper revenue threshold for a Medium registered entity to be $2 million. Further, we do not believe the financial reporting requirements applicable to small registered entities should be influenced by whether they are a deductible gift recipient.

Other comments

We provide the following additional comments.

- We believe further consideration should be given to the desirability of publishing investigative reports (see the note at sections 120-100) and warnings (see the note at 120-200) on the ACNC website. Commercial detriment needs to be considered and the disclosure of warnings could be prejudicial to the individuals or organisations involved. For example, a warning can be issued if the Commissioner has reasonable grounds to

believe that a registered entity or a responsible individual has contravened a provision of the Act. The organisation or the individual may not have contravened the Act despite the Commissioner's belief, yet by publishing the warning the reputational detriment is still suffered by the organisation or individual.

- If the ACNC as an executive body is purporting to determine contraventions of the ACNC Act and publish them, then arguably this could be an invalid exercise of judicial power by the executive, raising constitutional issues. Only the courts have the power to conclusively determine whether the Act has been contravened. We consider the proposed approach is also at odds with principles of natural justice.

- We believe it is inappropriate for the Commissioner to have a power to revoke the registration of a registered entity if he or she is satisfied that the continuing registration of the entity "may" cause harm to, or jeopardise, the public trust and confidence mentioned in section 2-5(1) of the Draft Bill (see section 10-55(1)(e)). We are also concerned about the possible implications of the ability of the Commissioner to revoke a registration if he or she "is satisfied" the registered entity "is likely" to become insolvent (see section 10-55(1)(d)). We believe that such a provision substitutes the business judgment of the regulator for that of the directors or responsible individuals, undermining the role of boards and potentially causing great harm to charities. To the extent it is envisaged the powers afforded to the Commissioner to "de-register" an entity actually involve the winding up of an entity without a court order and arguably go beyond what can be regarded as administrative powers, this proposal also raises constitutional issues. Again, we believe the proposal is inconsistent with principles of natural justice.

- We recommend that Treasury seek the advice of the Attorney General on areas where the proposals may be inconsistent with the separation of powers doctrine.

- There appears to be a typographical error in section 100-109(1)(j). We believe this should read "the date of effect of each registration of each registered entity".

- There appears to be no defence for responsible individuals under section 140-120 (2) "Non compliance with a direction". What if the reason the responsible individual fails to takes reasonable steps to ensure compliance because, for instance, they are in hospital or there was some other good reason as to why they could not do so? We believe the following defence may be appropriate - "The Court may, on application by any interested person and taking into account all of the circumstances surrounding the contravention, make an order, unconditionally or subject to such conditions as the Court imposes, relieving a person in whole or part from any liability in respect of a contravention of [insert relevant subsection]."

- The Draft Bill states that “The not-for-profit sector plays a unique role in Australia and is funded by donations from members of the public and by tax concessions, grants and other support from Australian governments” (section 3-5). We note that this statement is incomplete - for example, many organisations in the NFP sector are funded by consumer contributions by way of direct "fee for service". Many NFPs build their own assets/foundations which enable them to fund capital development and service programs, and in the health, disability and aged care sector for example, some services are funded via such things as private health insurance products, accommodation bonds, etc.

- We believe more consideration needs to be given to transitional provisions, especially where the proposed requirements (e.g. financial reporting requirements) are more onerous than those that currently apply to various types of charities (e.g. incorporated associations), and/or where expected red tape reductions from other regulatory agencies are yet to occur.

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