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The Legal Issues arising from the Productivity Commission Research Report

Background

On 3 November 2009 we published a Bulletin expressing our views on the draft Research Report prepared by the Productivity Commission which was issued in October 2009. The Productivity Commission invited written comments on that draft Report by 24 November 2009 and, having received those comments, has now released the final Report, which was made publicly available on 11 February 2010.

As was the case with the draft Report in October 2009, the most relevant chapter of the final Report, as far as legal issues are concerned, is Chapter 6 which deals with the regulation of the not-for-profit sector. If you feel overwhelmed by the prospect of reading a 441 page Report, you may find the time to read Chapter 6 which only comprises about 40 pages.



MAKINSON & d'APICE
— L A W Y E R S —

Level 12 135 King Street Sydney NSW 2000 • GPO Box 495 Sydney 2001 • DX 296 Sydney
Telephone 02 9233 7788 • Facsimile 02 9233 1550 • Email mail@makdap.com.au • www.makdap.com.au

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In our Bulletin of 3 November 2009, we commented on three specific legal issues, being the introduction of a single legal entity, the creation of national fundraising legislation and the establishment of a regulator for all not-for-profit organisations. This Bulletin, which is a summary of the final Report prepared by the Productivity Commission, will discuss what the final position of the Productivity Commission is on those three specific legal issues.

1. Single Legal Entity

The final Report explains that the majority of not-for-profit organisations (**NFPs**) are unincorporated and so largely fall outside the regulatory system which currently exists for NFPs. Of those NFPs which are incorporated, many are small in size and operate entirely within one State or Territory. With these small incorporated NFPs, although the overall regulatory regime works well, there is nevertheless confusion about the best form of legal structure; and the compliance costs are often not commensurate with the size or scope of the activity of the NFP in question. The Report states that it is the larger NFPs, which operate in more than one jurisdiction, which face an unnecessarily complex, confusing and costly regulatory environment.

Current commitments to improving NFP regulation

The final Report discloses that the Australian, State and Territory Governments have committed to improving the quality of NFP regulation and that progress has been made in this area, such as financial reporting and improving regulatory

processes. The author is yet to see first hand any direct benefits from the progress which has allegedly been made. The Report does acknowledge that much remains to be done in improving the quality of regulation in this sector.

The Report acknowledges that the compliance costs faced by NFPs are minimised when NFPs have to face a single, clear set of requirements (be that in relation to registration, tax endorsement or fundraising) with Government reporting standards and requirements, and where one report satisfies most, if not all, common obligations. The challenge, however, is to create a regulatory system that offers these advantages, but that is nevertheless proportionate to the risks posed by different kinds of NFPs.



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Should there be a new single national legal form?

So, should there be a new single national legal form? In this regard, the final Report of January 2010 largely mirrors the comments of the draft Report of October 2009. The final Report states that although a single national legal form would potentially be attractive for new entities, the migration of all currently existing entities to that new form would be required to address the concerns about disparate requirements. It would then be a challenge to determine which current requirements should remain, and which should be abolished. Further, NFPs' advisers are generally familiar with current structures such as public companies limited by guarantee and incorporated associations. In summary, the transition costs would be significant.

In addition, even with the introduction of a new single national legal form, some cases would remain which would require a specialised form.

It is the official view of the Productivity Commission that the current variety of legal forms, subject to the reforms which are proposed, offer scope for best fit, just as in the for-profit sector where legal forms range from sole traders through to public corporations. Nevertheless, the shortcomings of existing legal forms still need to be addressed. The concerns which exist in relation to existing legal forms fall broadly into three categories:

- (a) the initial choice of legal form is confusing for NFPs, often resulting in the "wrong" form being adopted;

- (b) the compliance requirements of legal forms are often inappropriate; and
- (c) legal forms are inconsistent across jurisdictions, which impose unnecessary costs.

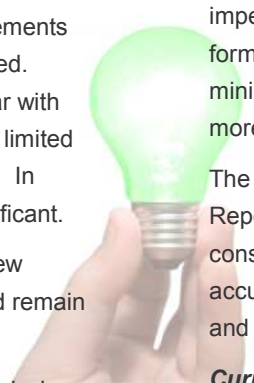
These concerns are compounded where migration across legal forms is difficult or prohibitively costly.

The Productivity Commission acknowledges that transaction costs, such as capital gains tax, stamp duty and registration fees, represent a significant impediment to NFPs migrating to different legal forms. Governments should therefore attempt to minimise the imposts which inhibit NFPs moving to more efficient and appropriate legal forms.

The Productivity Commission reported in its final Report that a clear message emerges from the consultations it held of the importance of targeted, accurate and timely advice to assist both existing and new NFPs.

Current attempts to simplify legal requirements

The Report did comment on current attempts to simplify and streamline the different requirements attached to different legal forms. For example, New South Wales, Victoria, Queensland and Tasmania have recently reviewed their *Associations Incorporation Acts* and introduced (or plan to introduce) simplified auditing and reporting requirements, and operating governance arrangements, in an effort to reduce the regulatory burden faced by incorporated associations. Further, at the Commonwealth level, reforms are proposed to the public company limited by guarantee form in the



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Corporations Amendments (Corporate Reporting Reform) Bill 2010, to address the disproportionate cost of reporting and the inappropriate focus of the legal form through a three-tiered differential reporting framework. The reforms are also aimed at streamlining assurance requirements and simplifying disclosures in the director's report, recognising that the focus of NFPs is generally purpose or objective driven. The reforms propose that whilst small (first tier) public companies limited by guarantee would be exempt, second and third tier companies will only need to prepare a simplified report containing:

- (a) a description of the short-term and long-term objective of that NFP;
- (b) the strategy of the NFP for achieving those objectives;
- (c) the principal activities of the NFP during the year;
- (d) how those activities assisted in achieving the objectives of the NFP; and
- (e) how the NFP measures its performance, including any key performance indicators used.

The Productivity Commission endorses the thrust of the reporting reforms proposed in this *Amendment Bill*, as they will supposedly make incorporation under the *Corporations Act* more attractive to NFPs, thereby reducing the need for a new national legal form as recommended in the draft Report of October 2009. Nevertheless, the Productivity Commission is still concerned about the no reporting requirement for first tier companies, preferring that those

companies still be required to prepare some form of directors' and financial reports, and to have them available on request.

The final Report, similar to the draft Report, discusses the problems arising from the differences in regulation across jurisdictions. This is especially of concern to those NFPs which operate across State and Territory boundaries. The typical suggestion is to arrange for the States and Territories to harmonise their associations incorporation legislation and mutually recognise registration across jurisdictions. It is noted that the Productivity Commission recognises that mutual recognition can be costly to administer.

Just as the support for the single legal form is weak, the case for centralising all regulation at the Commonwealth level is also not strong. The Report once again states that the Commonwealth should offer, but not mandate, a viable alternative in the form of the NFP public companies limited by guarantee, modified to provide proportionate reporting and other requirements.

Acknowledging that NFPs will choose the legal form that is actually more appropriate for them, the Productivity Commission is not recommending, in its final Report, that any threshold be applied to State and Territorial incorporation at this time.

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Summary

In summary, the Productivity Commission has put forward the following recommendations with regard to regulating NFPs:

- (a) the Australian Government should amend the *Corporations Act* to establish a separate chapter relating to not-for-profit companies which are limited by guarantee. This chapter should:
 - (i) embody the principles of proportionality in relation to reporting, fees and charges;
 - (ii) provide clear rules on the disposal of assets in the event of the NFP being dissolved or restructured, in addition to the proposed prohibition on the payment of dividends; and
 - (iii) include a plain English guide;
- (b) Australian Governments should pursue harmonisation of State and Territory based incorporated associations legislation, with an initial focus on:
 - (i) aligning NFPs' public, corporate and financial reporting requirements;
 - (ii) rules on the distribution of assets on the dissolution or restructuring of an NFP; and
 - (iii) allowing NFPs to migrate from one legal form to another, and to move to the Commonwealth jurisdiction without onerous transaction costs.

2. National Fundraising Legislation

With regard to national fundraising legislation, the final Report largely mirrors the draft Report, in that it lists once again the typical approaches to addressing the issues currently arising from different legislation in each State and Territory, being:

- (a) the mutual recognition of registration for a fundraising organisation or activity;
- (b) the harmonisation of State and Territory legislation; and
- (c) introducing national legislation.



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Mutual Recognition

The Productivity Commission recognises that mutual recognition of registration is rarely acceptable to governments, unless the differences between jurisdictions are trivial. Otherwise, it may result in “forum shopping”.

Harmonisation

The Commission viewed harmonisation as being a compelling alternative. Further, the review of fundraising legislation which would be required for harmonisation would also provide an opportunity for jurisdictions to address outdated and inappropriate legislation, including covering new ways of fundraising offered by technology, many of which inherently cross jurisdictional boundaries.

National legislation

The Report discloses that most participants in the study favoured the introduction of national fundraising legislation and a national regulator. As with harmonisation, developing a national fundraising act would also provide the opportunity to address shortcomings of the current State and Territory legislation. The Productivity Commission is attracted to a national fundraising act, although the Commission is reluctant to recommend this as an immediate change. It recognises that State and Territory Governments would be understandably hesitant to cede this power to the Commonwealth without knowing what form such national legislation might take. The Commission therefore suggests that governments proceed to a nationally consistent approach to fundraising in a staged manner, as follows:

- (a) first, the States and Territories develop harmonised fundraising legislation through the adoption of a model act;
- (b) second, the States and Territories mutually recognise the fundraising approval granted in other jurisdictions; and
- (c) finally, the States and Territories refer their powers to the Commonwealth to enact national fundraising legislation, based on the harmonised legislation agreed by the State and Territory governments and regulated by the proposed Registrar.

As ideal as this recommendation appears, the implementation of this regulation would invariably take many, many years.

3. Regulator for NFPs

The final Report, whilst acknowledging the innumerable difficulties which exist with the current system, acknowledges a sudden, revolutionary change would not be desirable. A more measured and gradual approach will improve certainty and reduce the cost of adjustment. It would also allow time to put in place important building blocks.

Introduction of a Registrar

The Productivity Commission, in its final Report, proposes a new Commonwealth organisation – the Registrar for Community and Charitable Purpose Organisations. This Registrar would be a “one-stop-shop” for NFPs, offering NFPs the advantage of one regulator for registration and tax endorsements, the submission of corporate and financial information,

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and the registration of national and/or cross jurisdictional fundraising activities. As with the draft Report, it is submitted that the Registrar could be a separate agency, or it could be a statutory body or organ within ASIC.

Initially part of ASIC

It is the opinion of the Productivity Commission that the Registrar should initially be established within ASIC as a separate entity (rather than as a new, stand-alone organisation), due to:

- (a) the reporting amendments noted above which will make the public company limited by guarantee form more attractive for NFPs operating in multiple jurisdictions and this form is already administered by ASIC under the *Corporations Act*;
- (b) many synergies associated with locating the Registrar within ASIC; and
- (c) the precedence of ASIC successfully establishing separate bodies within its organisation.

Summary

The final recommendations of the Productivity Commission with respect to the regulator are as follows:

- (a) the Australian Government should establish a “one-stop-shop” for Commonwealth regulation by consolidating various regulatory functions into a new national Registrar for Community and Charitable Purpose Organisations. Ultimately the Registrar could be an independent statutory body. Initially it should be established as a statutory body corporate or organ in ASIC;
- (b) the Registrar will undertake the following key functions:
 - (i) registering and regulating NFPs which are companies limited by guarantee and indigenous corporations;
 - (ii) assessing the eligibility of NFP organisations for Commonwealth tax concession status endorsement and maintaining a register of endorsed organisations;
 - (iii) registering cross-jurisdictional fundraising organisations and/or activities by NFPs;
 - (iv) providing a single reporting portal for public record corporate and financial information;
 - (v) providing appropriate guidance in relation to governance matters;
 - (vi) investigating compliance with regulatory requirements; and
 - (vii) providing complaints handling in respect of the above functions;
- (c) the Registrar should implement the principle of “report once, use often” by providing a single reporting portal and form for annual reporting on community-purpose, governance arrangements, financial accounts and fundraising activity. Australian governments can then support this principle and

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- (d) substantially reduce compliance costs for NFP organisations by:
 - (i) adopting and developing an implementation strategy for the Standard Chart of Accounts for reporting by NFPs in receipt of government grants or service contracts;
 - (ii) expanding the Standard Business Reporting initiative to include reporting requirements by NFPs; and
 - (iii) encouraging their agencies to utilise the governance and financial account information (that will be lodged with the Registrar) to meet their organisation level “*health check*” requirements for contracting purposes.

Conclusion

You will note that the final Report does not differ in any great respect from the draft Report published in October last year. As attractive, and also frightening, as some of these recommendations may first appear to be, please keep in mind that the implementation of any of these recommendations in any form would be a long and drawn out process, involving the jumping of many more hurdles and requiring years to implement. ■

