

Individuals and Indirect Tax Division

The Treasury
Langton Crescent
PARKES ACT 2600

By email: ExternalConductStandards@treasury.gov.au

Dear Sir/Madam,

External conduct standards for charities registered with the Australian Charities and Not-for-profits Commission

The Law Institute of Victoria ('LIV') is grateful for the opportunity to provide comments on the External conduct standards for charities registered with the Australian Charities and Not-for-profits Commission ('**Exposure Draft**').

Introduction

The LIV is Victoria's peak body for lawyers and represents more than 19,500 people working and studying in the legal sector in Victoria, interstate and overseas.

The LIV makes its submission in three major parts: first, the Exposure Draft; second, LIV's general observations about the purpose of the external conduct standards; and third, other observations and considerations the LIV notes as important.

1. Exposure Draft

The Exposure Draft includes four proposed external conduct standards ('**Standards**'): 1) Activities and control of resources (including funds), 2) Annual review of overseas activities and record-keeping, 3) Anti-fraud and anti-corruption, and 4) Protection of vulnerable individuals.

Schedule 1 - Amendments: Section 4

Third party

The LIV is concerned about the broad definition of 'third party' as '*an entity that formally or informally collaborates with the registered entity for the purpose of advancing the registered entity's purpose or purposes and includes:*

- (a) An entity with which the registered entity has some form of membership association or alliance; and*
- (b) An entity that has an arrangement with the registered entity.'*

And 'arrangement means any arrangement, agreement, understanding, promise or undertaking, whether express or implied, and whether or not enforceable (or intended to be enforceable) by legal proceedings.¹

The LIV submits that given that a charity with income tax exemption must apply its income and assets solely for the purpose for which the entity is established, this definition is problematic because every entity which a charity has a financial exchange or 'arrangement' may constitute a 'third party'.

Indeed, the third party may itself be a registered entity which is itself subject to the Standards. This creates unnecessary regulatory duplication and the potential for each registered charity in a consortium or 'supply chain' arrangement to have full responsibility to comply separately with the Standards. The LIV submits that this is contrary to the purpose of creating a reliable ACNC register upon which the public and other registered entities can rely and is contrary to the object of red tape reduction. Whilst proposed Standard 2(3)(b) contains a passing recognition of the above issue (by excluding resources 'provided to another registered entity'), the other proposed standards do not address this issue.

The LIV submits that the better approach is for the definition of 'third party' to expressly exclude another registered entity.

Vulnerable individual

The LIV submits 'vulnerable individual' is similarly broad in definition, and the proposed Standard 4 may go beyond the reporting that is currently in place regarding children or disabled persons. The LIV submits the level of regulatory burden should be considered and clarified.

Schedule 1 - Amendments: Subdivision 50.4 (1) and (2)

Application - operating outside Australia

This subdivision sets out the application of the Standards. Subdivision 50.4(1) provides '*...a registered entity, or a third party, operates outside Australia if it operates outside Australia in whole or in part*'. The LIV submits this definition is unclear about what to 'operate' means.

Subdivision 50.4(2) also provides '*however a registered entity does not operate outside Australia only because it carries out activities outside Australia that are merely incidental to the operation and pursuit of a registered entity's purposes in Australia*.'

The LIV has reviewed the examples in the Explanatory Memorandum to the Standards and considers it reasonable to conclude that where a charity has objects and purposes that are merely related to Australia and people within Australia, conducting activities outside Australia will not meet the definition of 'operates outside Australia'. The LIV notes it appears the entity must have a charitable purpose that is not confined to Australia.

The LIV is concerned the provision allows discretion for entities to decide whether they are captured by the Standards. The LIV suggests that given the consequences of not complying, the application of the provision should be made clearer.

Schedule 1 - Amendments: Subdivision 50.20 (1) and (2)

¹ *Income Tax Assessment Act 1997* (Cth).

Object

The LIV submits these objects are not specific to entities that operate outside Australia and do not clearly target the risk of terrorist or crime financing. It is further noted they may already be captured by the current legislative matrix that applies to registered charities. Therefore, the LIV queries whether the Standards are necessary for achieving these objects.

Application

Regarding '*application*', the LIV submits that the unclear definition of 'operating outside Australia' makes it difficult to determine the ambit of the provision. Furthermore, the unclear definition of 'third party' and 'working with third parties' exacerbates the problematic application of this provision. The LIV queries whether 'working with' should capture conduct that is more than having a form of membership association, alliance or arrangement with the registered entity.

Schedule 1 - Amendments: Subdivision 50.20 (3)

The LIV notes this provision requires an income tax exempt charity to comply with all the substantive requirements of its governing rules and apply its income and assets solely for the purpose for which the entity is established (50-55(2) ITAA 1997). The LIV understands this provision prescribes reasonable steps be taken to achieve the requirement.

The LIV submits it is the process and not the outcome that is caught by this provision. In other words, it intends to control what steps or processes the charity takes to manage risks as opposed to whether the charity succeeds at managing the risk.

The LIV is concerned the lack of clarity about 'reasonable steps' makes this provision difficult to satisfy. In particular, what constitutes 'reasonable steps' in Australia may be quite different from what is reasonable in the context of unstable areas, conflict zones or areas subject to natural disasters or subject to governments which may not adhere to Australian or internationally accepted Standards. The LIV submits that the concept of 'reasonable steps' should be expressly defined to mean 'reasonable steps having regard to the relevant circumstances and context'.

Schedule 1 - Amendments: Subdivision 50.20 (4)

Subdivision 4 requires a charity registered in Australia to comply with certain Australian laws. However, the LIV notes that the entity would have already been bound by those laws, to comply. Therefore, this provision may be unnecessary.

If some of those laws listed, must be made applicable or applicable to a higher standard, the LIV recommends a consideration of the extent of the burden on charities be given. The LIV suggests the provision be made clearer to avoid this confusion by inserting 'applicable' before 'Australian laws' in line 1.

The LIV notes a potential problematic scenario is that where in the past a charity was in breach of any one of these laws through its own actions or the actions of its employees or agents, the consequence would be as provided by the relevant legislation. However, this provision suggests breach of any of these laws may have dire consequences on the charity's registration. In expressing its concerns, the LIV wishes to draw attention to the ACNC Review Report which recommended removing Governance Standard 3. The LIV submits the same reasoning applies here, and subdivision 50.20(4) should be removed. The text of subdivision 50.20(4) may, we suggest, be used by the ACNC as part of an updated 'Governance for Good' guidance publication for charities operating overseas.

Schedule 1 - Amendments: Subdivision 50.20 (5)

The LIV is concerned about the ambiguity of this subdivision and queries whether there needs to be specific examples of 'reasonable internal control procedures' in the legislation. For example, it should be considered whether it requires:

1. collating the laws under each heading in (a) to (i)
2. assessing their application to each charity - considering the actions of those for whom the charity would be vicariously liable
3. putting control procedures in place for each of these.

If these three elements are required, the LIV submits the provision is overly onerous.

Alternatively, if 'reasonable internal control procedures' pertains to operating with basic good governance and attention to operations then the provision will be more workable. Even so, the LIV submits further guidance about what 'reasonable internal control procedures' are is required.

Schedule 1 - Amendments: Subdivision 50.25 (1) and (2)

The LIV submits this provision is a reasonable object for a Standard. However, regarding 'Application', (as with Standard 1) it is unclear how this Standard will be applied.

Schedule 1 - Amendments: Subdivision 50.25 (3), (4) and (5)

The LIV notes that the Explanatory Memorandum provides that there will be guidance about what is required for these reports before the conduct rules come into operation. It also emphasises that the information or 'summary' is to be included in the entity's annual information statement and provided to the Commissioner. The LIV queries whether there are any privacy issues which may arise from an entity being required to provide this information to the Commissioner and whether the information will be deidentified and not published outside the Commissioner's office.

The LIV also queries whether there is an element of an entity being required to demonstrate the effectiveness of its overseas activities, thereby hindering the role of directors of the entity to manage the entity's affairs efficiently and effectively.

Schedule 1 - Amendments: Subdivision 50.30 (1), (2) and (3)

The LIV submits, as is the case with subdivision 50.20, these objects are not unique to entities operating overseas. However, as with Standard 1, it is unclear how this Standard will be applied.

The LIV accepts the proposed provision is relevant for the Standards. However, it is unclear what constitutes 'reasonable steps', as noted above.

The proposed Standard requires the registered entity to 'minimise any risk' of corruption, fraud or bribery. The LIV submits that this provision should instead require registered entities to 'mitigate the risk', which better reflects the Department of Foreign Affairs and Trades ('DFAT') overseas development aid approach. DFAT's approach emphasises fraud and corruption reporting, transparency and investigation as opposed to a focus on the upfront elimination of all such risks (which may be impossible, particularly in fragile or conflict settings).

The provision refers to reasonable steps to document any perceived material conflict of interest for employees, volunteers, third parties and responsible entities outside Australia. The LIV submits this is

achievable in relation to responsible entities. However, the LIV foresees the requirement may be problematic if it requires a 'conflicts register' for each category.

Schedule 1 - Amendments: Subdivision 50.35 (1), (2), (3) and (4)

Object

The LIV submits the 'object' is not clearly relevant to the original stated intention of the Standards, and further queries whether there is evidence to support a higher risk of abuse occurs when charities conduct activities overseas.

Application

As with Standard 1, it is unclear how this Standard will be applied. The reasonable standards required are to 'ensure the safety' which is beyond a 'do no harm' requirement. The provision creates a positive duty to protect, not only in relation to the activities of the charity.

However, the definition of 'vulnerable person' is broad and may go beyond the reporting that is currently undertaken regarding children or those with a disability. The LIV seeks clarification about the extent of regulatory oversight which is intended here.

Taking reasonable steps to protect a vulnerable person requires an assessment of the person's vulnerability, which potentially involves interviewing intended beneficiaries to discern if there is past trauma or relevant medical conditions. The LIV submits this creates serious practical difficulties for neutral and independent humanitarian action in fragile or conflict settings.

2. Purpose of the Standards

The LIV notes the external affairs power confers constitutional power for the enactment of the Standards.² Accordingly, the Standards can deal only with 'matters external to Australia' or 'matters not external to Australia but that are closely related to, or have or will have a significant impact on, entities, things or matters external to Australia'.³ The Explanatory Memorandum for the *Australian Charities and Not-for-profits Commission Act 2012* (Cth) ('**ACNC Act**') suggests that the fundamental purpose is to regulate funds which have been sent overseas. At paragraph 2.12 the Explanatory Memorandum for the ACNC Act states:

'The external affairs power supports section 50-10 of the Bill in Part 3-1, which empowers the Governor-General to make regulations, specifying the 'external conduct standards', for the purpose of regulating funds sent by NFPs outside Australia and activities engaged in by such entities outside Australia.'

In addition, paragraphs 5.57 to 5.70 of the Explanatory Memorandum target charities funding illegal or terrorist activities overseas. The first three of these paragraphs are extracted here:

'5.57 Australian NFP entities in the past have sometimes provided support for terrorist and other criminal activities. Often they did so unknowingly but occasionally did so deliberately, whether to directly help the organisations conducting those illegal activities or as a means to achieving their legitimate charitable ends.'

² S 51(xxxix) *Commonwealth of Australia Constitution Act 1901* (Cth).

³ S 50.10 *Australian Charities and Not-for-profits Commission Act 2012* (Cth).

5.58 The purpose of these external conduct standards is to prevent Australian registered entities providing support in the future and so promote transparency and confidence across the sector and the general public that charitable funds and services are applied for legitimate purposes, and are not contributing to terrorist or other criminal activities (from an Australian perspective). [Subsection 50-5(1)]

5.59 The external conduct standards are expected to be based on the requirements of the Financial Action Task Force's (FATF) Special Recommendation VIII (SR VIII), and help combat the terrorist and criminal activities covered in the FATF recommendation.'

The LIV is concerned that these additional prerogatives do not fit within the original purpose for the proposed amendments, especially in light of Standard 4.

3. Other observations and considerations

Focus on money laundering and terrorism financing

The LIV draws attention to the joint ACNC and Australian Transaction Reports and Analysis Centre ('AUSTRAC') review released in August 2017 which found that the risk level for both money laundering and terrorism financing is 'medium'. The LIV submits this acts as evidence contrary to the concern about counter terrorism and anti-money laundering. The LIV suggests there be a reconsideration of the focus by first questioning whether the Standards are proportionate to the concern.

Unreasonable burden on charities

The LIV is concerned there is an unreasonable burden placed on charities, in light of the obligations placed on the business sector. The business sector is regulated by external bodies which monitor and investigate alleged misconduct with a level of burden that is significantly lower. For example, businesses are not required to provide evidence in the way that is required of registered charities under the Standards.

An overarching purpose of charities is to deliver benefits to beneficiaries, with 'public trust and confidence' being natural consequences of such delivery. Whilst the regulator recognises that high administration costs do not necessarily indicate poor operation of a charity, most charities still find it extremely difficult to keep administration costs low and meet public expectations.⁴

The LIV is concerned these Standards add to the burden of this obligation, and observes that funds are not donated for the purposes of satisfying these Standards.

Whilst the LIV acknowledges charities have a distinct role in society (with appropriate tax concessions) this distinction does not justify the degree of burden that would be placed on them by the Standards. Unless there is evidence to support the proposition that the Standards will increase the standard of operations, the LIV cannot agree the burden on charities is reasonable. The LIV submits the Standards may undesirably discourage small charities from performing charitable work overseas.

Lack of clarity

The LIV has highlighted the lack of clarity in various proposed amendments, and queries whether the Standards will promote the effective use of charitable resources. The LIV submits the uncertainty in

⁴ See Australian Government, Australian Charities and Not-for-profits Commission <
http://www.acnc.gov.au/ACNC/FAQs/FAQ_Charity_and_administration_costs.aspx>.

definitions and the application of these Standards may result in hardship for the charities sector and difficulty for board members in determining how to comply.

The LIV recommends that these requirements be made as precise as the Australian Council for International Development (Non-profit) code of conduct.

In the alternative, if ambiguity throughout these Standards is unavoidable, then there should be consideration given in the case of failure by an entity to comply.

Further consultation and contact

The LIV would be pleased to discuss this submission with you in greater detail. Please contact Angela Gidley-Curtin, LIV Senior Lawyer and Sections Counsel, on (03) 9607 9409 or at agidleycurtin@liv.asn.au, to arrange a time to meet together with representatives of the Committee.

Yours sincerely,



Belinda Wilson

**President
Law Institute of Victoria**