

A 'one stop shop' opportunity for better not-for-profit regulation

Submission to Treasury's consultation paper as part of the scoping study for a national not-for-profit regulator

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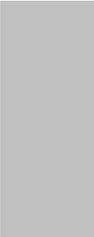


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Endorsements

This submission is endorsed by the following organisations:

- ▶ Victorian Council of Social Service (VCOSS)
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1. Executive Summary

PilchConnect welcomes the opportunity to make a submission to Treasury's scoping study for a national not-for-profit (NFP) regulator, and is pleased that the Commonwealth Government is undertaking this scoping study in line with its 2010 commitment to deliver smarter regulation, reduce red tape and improve transparency and accountability of the sector.¹ We applaud the Government for undertaking this latest step which focuses on the practical considerations that must be addressed before reform can take place.

The establishment of an independent 'one-stop-shop' regulator should be viewed as a significant step in long-overdue reform for Australia's NFP sector. However throughout the development of a new framework, a fundamental consideration that must be kept in mind – we must not allow for a situation that serves to exacerbate the current problems by simply creating a further level of bureaucracy without any real improvement to efficiency, transparency and accountability for NFPs.

Treasury will be aware that the regulatory framework applying to the majority of Australia's incorporated NFP entities does not currently support simple, 'one-stop-shop' compliance. Instead the current framework provides multiple barriers to growth, accountability and efficiency. There is a high burden and high cost of regulation and as a result limited community resources (including management and volunteer time and funding) are being wasted. This scoping study represents an opportunity to improve the regulatory approach to NFPs through the creation of a streamlined regulatory framework that promotes consistency, transparency and clarity for both NFPs and the general public.

For ease of reference, this submission addresses each of the Consultation Paper's 31 questions in sequence and draws on our earlier policy work,² particularly the following submissions:

- ▶ PilchConnect submissions to the Productivity Commission Research Report on the 'Contribution of the Not-for-Profit Sector' - initial submission, June 2009 (**first submission**) and follow-up submission on the draft report, November 2009 (**follow-up submission**), both at <http://www.pilch.org.au/submissions/#6>
- ▶ PilchConnect submission titled 'Time for underpinning: a national regulatory approach for the not-for-profit sector' made in response to the 2008 Senate Economics Committee 'Inquiry into disclosure regimes for charities and not-for-profit organisations' (**2008 Senate Inquiry**), at <http://www.pilch.org.au/pastsubmissions/#5>
- ▶ PilchConnect submission titled 'Removing complexity, adding coherence: A proper framework for concessional tax treatment of charities and not-for-profit entities' made to Australia's Future Tax System Review Panel by the Senate Economics Committee, October 2008 (**Henry Tax Review**) at <http://www.pilch.org.au/pastsubmissions/#4>.

In this submission, PilchConnect emphasises the following views which we see critical to this consultation:

¹ <http://www.alp.org.au/agenda/more---policies/historic-reforms-to-australia-s-not-for-profit-sec/>

² All of PilchConnect's previous submissions can be viewed at www.pilch.org.au/submissions. A full list of PilchConnect's submissions is included as an appendix to this submission.

1.1 Form of a national regulator (sections 13-15 of our submission)

The independence of a new national NFP regulator is critical. PilchConnect strongly endorses the Consultation Paper's statement that 'an independent national NFP regulator would provide the greatest benefits to the public, the sector and to governments, in terms of reducing red tape and ... streamlining reporting arrangements.' The establishment of an independent national regulator should be the ultimate aim of any reform initiatives (see section 13, below).

We do not support the creation of an 'interim' regulator within the ATO or ASIC as canvassed in the Consultation Paper, for reasons including the below:

- ▶ The ATO and ASIC are institutionally entrenched in regulating the 'for-profit' context. Their overarching philosophies, objectives and approaches are deeply incompatible with the effective regulation of the voluntary sector.
- ▶ Both the ATO and ASIC are focused on enforcement and are known to rigorously investigate and prosecute contraventions. The vast majority of the NFP sector needs a more non-threatening regulator that will work with them to support compliance and good governance, as well as using powers in cases of serious misconduct such as fraud.
- ▶ Regulation of NFPs should be a minor part of the overall functions of both the ATO and ASIC. An independent regulator, with a specific mandate and direct funding from Parliament, would result in a better system of NFP regulation and increase public trust and confidence in the sector.

In particular, we do not support the establishment of a new regulator within the existing structure of the ATO. The undesirability of the ATO's role with regard to NFP regulation has been expressed in every major inquiry and report delivered to Australian governments for over a decade. In particular:

- ▶ The ATO's primary role is to administer taxation laws to protect the national revenue base. There is a fundamental conflict between this primary function and the ATO's role in determining eligibility for NFP tax concessions. This is not merely a 'perceived' risk of a 'possible' conflict – we submit it is entirely inappropriate for the ATO to be the decision-maker of NFP charitable status given its inherent responsibilities to protect revenue.
- ▶ The ATO has expertise in charitable and NFP law *insofar as they relate to the taxation treatment of NFPs*. The ATO does not have experience in regulating areas which would be key for an NFP regulator, such as the collection and public dissemination of corporate information via a public register. In these areas ASIC has considerably more expertise and systems than the ATO.
- ▶ We understand that the ATO itself does not want the role. Indeed, the ATO has previously expressed the view that NFP administration would be better served by a single, independent common point of decisions-making on definitions of charitable or non-profit status.³

Any regulator mandated to oversee the NFP sector must have sufficient resources and expertise to develop policy, educate and communicate effectively with the sector (see section 14).

³ See the ATO's submission to the 2001 Inquiry into the Definition of Charities and Related Organisations, available at www.cdi.gov.au/html/public_submissions.htm

1.2 Constitutional and jurisdictional issues (section 12)

The preferable method for national regulation is by a referral of powers from the states to the Commonwealth to support the introduction of national legislation for the regulation of NFPs, including an independent NFP regulator. We appreciate that referral of powers requires a high level of political cooperation between governments. However the development of corporate (for-profit) law highlights that the states can quickly be harnessed into action to endorse a nation approach when necessary, without undermining their ongoing roles.

In the absence of a timely referral of powers by the states, a national regulator could nevertheless start by regulating those entities already under Commonwealth jurisdiction (eg. companies limited by guarantee, NFPs endorsed for tax concessions) and its scope may then be expanded once the benefits of national regulation are more widely acknowledged.

1.3 Functions of the national regulator (sections 7-11)

PilchConnect supports the creation of an independent regulatory body dedicated to overseeing the NFP sector that will:

- ▶ serve as the lynchpin for the introduction of national regulatory reform that encompasses fundraising, incorporation, data collection and reporting;
- ▶ enable more difficult and contentious issues such as charitable status for tax concessions to be handled in an independent, measured and properly researched manner; and
- ▶ align Australia with other jurisdictions and, by being a broader model than simply a ‘charity’ commission, demonstrate leadership by implementing a regulatory approach that is appealing to international counterparts.

We support the creation of a national regulator with real enforcement powers and a presence and influence in the sector. However we caution against an approach which is overly focussed on a deterrence model that seeks to ‘police’ the sector. Our experience (supported by previous statements made by the ATO) highlights the high level of voluntary compliance in the NFP sector. Given the role that NFPs play in providing vital services to the community and contributing to civil society, the new regulator should adopt a responsive model of regulation that works *with* the sector to promote compliance and best practice (see section 10).

While we agree that the regulator has a key role in the oversight of governance for the NFP sector which could include the endorsement of a best practice regulatory framework⁴, we are concerned that Treasury’s suggested ‘core rules’ do not appear to be consistent with existing legislative and common law duties. It is unclear where duties of ‘compliance’ and ‘prudence’ will fit with existing (possibly overlapping) duties currently imposed on those governing NFPs, nor is it clear why a ‘fit and proper person’ test should be extended to all NFPs. We submit that while minimum governance standards are important, any ‘core rules’ should be commensurate with the NFP’s activities and size, and not simply add another layer of regulation that causes confusion about well-established governance and accountability standards (see section 10).

As we have argued in previous submissions, the Australian NFP sector needs one overall simplified tax concession scheme underpinned by a rational basis for the determination of charitable status. The need for taxation reform should not, however, be seen as a justification for locating a new national NFP regulator

⁴ Treasury Consultation Paper at [102] to [112].

within the ATO. On the contrary, as noted above, the ATO's current role as 'default' NFP regulator at the Commonwealth level is one of the strongest arguments for establishing an *independent* national regulator to (amongst other things) determine charitable status for tax concessions in an unbiased, measured and properly researched manner (see section 7).

PilchConnect recognises the important role a national regulator could play in facilitating access to information and advice for NFPs. However we do not support a proposal for the national regulator to 'take over' the educational functions currently provided by intermediaries such as peak bodies and sector-based support services. PilchConnect recommends that:

- ▶ education and compliance initiatives of a new national regulator be specifically focused around the provision of accessible information, guidance material and technologies to assist NFPs to understand their obligations and interface with the new regulator, and
- ▶ more government funding be made available for sector-based support services to assist NFPs in meeting their compliance obligations and promoting good governance (see section 8).

1.4 Scope of the national regulator (sections 4-6)

The scope of this national regulator raises two critical issues: *who* will fall within the ambit of the national regulator; and *how* will those NFPs within its ambit be treated.

Our preferred approach to national regulatory reform would see the introduction of a specialist legal structure for NFPs. However if this approach is not accepted, we submit the scope of the national regulator should include the following types of entities:

- ▶ incorporated NFPs (eg. companies limited by guarantee, incorporated associations), and
- ▶ other NFP entities that receive public donations, are in receipt of tax concessions and/or government funding (eg. DGR public funds, charitable trusts).

Limiting the scope of the national regulation to entities receiving 'public or government monies (through donations, taxation concessions or contracts for services)'⁵ would, in our view, fall short of recognising the diversity of the sector, and add to the complexity of regulation for many NFPs rather than reduce it – for example, many state-based NFPs would continue to be regulated at the federal level (for tax concessions) and at state level (for incorporation registration).

Of the 136,000 incorporated associations in Australia, we consider the vast majority would be reluctant to voluntarily migrate to a new regulatory regime without clear benefits on offer. If, however, a new national framework (and a 'one stop shop' regulator) were seen as an attractive and accessible alternative to state-based regulation,⁶ incorporated associations may be more likely to move to a national framework (see section 6).

⁵ See Treasury Consultation Paper at [42].

⁶ We have expressed concern in previous submissions that the legislative approach to incorporated associations, as it current stands, is inadequate for small, grassroots organisations. For example, recent reforms to the Victorian *Associations Incorporation Act 1981* (Vic) will, amongst other measures, apply parts of the *Corporations Act 2001* (Cth) to the associations regime. The complexity of this approach means it does not work smoothly for local volunteer-run groups with very little support because it requires those involved to be familiar with two separate governing Acts. For further information see PilchConnect's submission on the Exposure Draft of the *Associations Incorporation Amendment Bill 2010* (Vic) available at <http://www.pilch.org.au/submissions/#4>

On the question of *how* national regulation of these organisations should be approached, we support a national regulator with a broad scope but submit that it is inappropriate for it to regulate all NFPs in the same way. The current diversity of the NFP sector necessitates a flexible approach to the regulation of NFPs, which takes into account the size and nature of the entity, the level of risk posed, the tax concessions received and the amount of government and public monies received.⁷

1.5 The goals of NFP regulation (section 3)

PilchConnect agrees that the goals identified in the Consultation Paper are appropriate for national regulation. Two overarching goals which should act as guiding principles for regulatory reform are:

- ▶ the promotion of public trust and confidence in the sector
- ▶ the streamlining of requirements, including reporting, so as to minimise compliance costs and provide consistency for Australian NFPs.

Given the enormous contribution the NFP sector makes to Australia's economic and civil society, NFPs deserve fair regulation that is appropriate to their mission-driven nature and operations.

Through the establishment of an independent, specialist and sufficiently-resourced national regulator, Australian governments can have an enduring impact on the effectiveness of the regulatory regime for NFPs which, in turn, will maximise the sector's contribution to Australian society.

⁷ The Federal Government's introduction of a three-tiered reporting regime for the 'company limited by guarantee' legal structure is a positive step in recognising that the approach to regulatory compliance amongst NFPs should take into account sliding scales of needs for transparency and compliance burdens.

2. About PILCH and PilchConnect

2.1 PILCH

PILCH is a leading Victorian, not-for-profit organisation. It is committed to furthering the public interest, improving access to justice and protecting human rights by facilitating the provision of pro bono legal services and undertaking law reform, policy work and legal education. In carrying out its mission, PILCH seeks to:

- ▶ address disadvantage and marginalisation in the community;
- ▶ effect structural change to address injustice; and
- ▶ foster a strong pro bono culture in Victoria; and, increase the pro bono capacity of the legal profession.

2.2 PilchConnect

PilchConnect is PILCH's specialist legal service for Victorian not-for-profit community organisations (NFPs). In particular, PilchConnect's focus is on providing legal help to NFPs that work with marginalised or disadvantaged Victorians. Our legal services for NFPs include free and low cost legal information (via a webportal, www.pilchconnect.org.au), legal training, and legal advice and referral of eligible NFPs to PILCH member law firms for pro bono assistance. PilchConnect also engages in law reform and advocacy work on systemic issues about the regulation of the NFP sector. Our submission work is based on empirical evidence and practical examples drawn from our legal inquiry, advice and case work.

We welcome the opportunity to provide input into Treasury's scoping study.

3. The goals of NFP regulation

Q1. Are these goals appropriate and adequate for national regulation? Which of these are most important?

Q2. Are there any other goals for national regulation?

PilchConnect agrees that the goals identified in the Consultation Paper are appropriate for a national regulatory framework. In our view, there are two overarching goals which form the key guiding principles for any future regulatory reform:

- ▶ the **promotion of public trust and confidence in the sector** through the establishment a national regulatory framework focussed on ensuring good governance, transparency and accountability, and
- ▶ the **streamlining of requirements, including reporting**, so as to minimise compliance costs and provide consistency for Australian NFPs.

Nearly all NFP organisations rely on public trust and confidence in some way, even those that do not rely significantly on monetary donations from the general public or receive tax concessions. For example, people are less likely to become members or volunteer their time to an NFP if they do not believe the group is well governed and ‘trustworthy’. Unlike in the business context, where consumer decisions are typically based on need or want without particular attention to governance or administrative costs, individuals’ decisions to donate time and money to an NFP are discretionary. Their support can quickly be retracted if there is a perception that the benefit is not going directly to the purpose for which it was given, or excessive amounts are being spent on ‘administrative costs’ as opposed to actual service delivery.⁸

Reform is desperately needed to address inconsistencies and duplications in the current framework which are causing some NFPs to be excessively regulated and others hardly (or not) at all. We agree with the Consultation Paper’s statement that current regulation is overly complex, inefficient and imposes a significant regulatory burden on NFPs without providing appropriate levels of governance support, transparency or accountability. We submit that the goals for regulation identified by Treasury in its Consultation Paper are best achieved by a national regulatory approach, with an independent body dedicated to overseeing the NFP sector that will:

- ▶ serve as the lynchpin for the introduction of national regulatory reform that encompasses fundraising, incorporation, data collection and reporting;
- ▶ enable more difficult and contentious issues such as charitable status for tax concessions to be handled in an independent, measured and properly researched manner; and
- ▶ align Australia with other jurisdictions and, by being a broader model than simply a ‘charity’ commission, demonstrate leadership by implementing a regulatory approach that is appealing to international counterparts.

The ultimate objective of reform should be the creation of a strong and sustainable Australian NFP sector through smart, appropriate, consistent and coordinated regulation.

⁸ There is much written on the importance of public trust and confidence in the NFP sector, in particular see the work of the Charity Commission of England and Wales where annual surveys of public trust and confidence are used as a key performance indicator for the Commission: see http://www.charity-commission.gov.uk/About_us/About_charities/Our_research_index.aspx

4. The scope of the national regulator

Q3. What should the scope of a national NFP regulator be? What types of entities should be regulated by a national NFP regulator?

Q4. Should some legal forms be treated differently? If so why?

The Consultation Paper notes that effective regulation must apply broadly across the NFP sector, notwithstanding that the sector encompasses a diverse group of entities with a variety of legal forms.⁹ The Paper also suggests that problems arising from the variety of legal forms may be partly overcome by a consistent regulatory framework covering all entity types. We agree. We also refer Treasury to previous submissions¹⁰ where we have argued that many of the problems associated with the range of legal forms currently available to NFPs could be rectified by the introduction of a specialist national NFP legal structure, which would then come within the scope of the national regulator.¹¹

In the absence of specialist national legal structure, the scope of national NFP regulation raises two critical questions: *who* will fall within the ambit of the regulator; and *how* will those within its ambit be treated?

On the question of *who*, we recommend the scope of the national regulator include the following types of entities:

- ▶ incorporated NFPs (eg. companies limited by guarantee, incorporated associations),¹² and
- ▶ other NFP entities that receive public donations, are in receipt of tax concessions and/or government funding (eg. DGR public funds, charitable trusts).

As highlighted throughout the Consultation paper, the NFP sector is characterised by its diversity. Limiting the scope of the national regulation to entities receiving ‘public or government monies (through donations, taxation concessions or contracts for services)’¹³ would, in our view:

- ▶ exacerbate the complexity of regulation for many NFPs, rather than reduce it. For example, a small NFP that is (initially) funded by membership fees would presumably have to ‘switch’ regulators if at any time it were to receive a non-recurrent government grant, have a public fundraiser, or apply for income tax exemption. A far simpler system would be to regulate all entities that have an NFP incorporated structure – this will allow NFPs to grow and change over time, without having change regulatory framework.
- ▶ potentially undervalue the contribution of NFPs falling outside this scope. For example, local clubs and sporting groups, which provide benefits to members rather than services to the broader community, are an important part of the NFP sector. These groups are often a focal point for local community building and social inclusion. They should share in the benefits of national NFP regulation.

If public trust and confidence in the NFP sector in all its diversity is a key goal of national regulation, we see no reason why, as a matter of principle, some NFPs should be regulated and not others.

9 Treasury Consultation Paper at [42].

10 See in particular PilchConnect’s submission to the 2008 Senate Inquiry (at p 28) and first submission to the Productivity Commission (at p 11).

11 Available at www.pc.gov.au/projects/study/not-for-profit/submissions

12 As to Indigenous corporations, see our response in section 15 below.

13 Treasury Consultation Paper at [42].

We acknowledge however, as a matter of practicality, there may be difficulties for a national regulator to achieve a broad scope at the outset (at least, without a referral of powers – see section 12 below). If it is not possible to regulate all incorporated NFPs initially, we nevertheless see benefit in establishing an independent national regulator to regulate entities already within the Commonwealth’s jurisdiction (see sections 12 and 13 below).

On the question of *how* national regulation of these organisations should be approached, we support a national regulator with a broad scope but submit that it is inappropriate for it to regulate all NFPs in the same way. The current diversity of the NFP sector necessitates a flexible approach to the regulation of NFPs, which takes into account the size and nature of the entity, the level of risk posed, the tax concessions received and the amount of government and public monies received. The Government’s introduction of a three-tiered reporting regime for the company-limited-by guarantee legal structure¹⁴ is a positive step in recognising that the approach to regulatory compliance amongst NFPs should take into account sliding scales of needs for transparency and compliance burdens.

We further note the Consultation Paper’s observation that 75 percent of organisations in the sector are small, unincorporated groups largely falling outside of the current regulatory framework. Consistent with previous submissions,¹⁵ we submit that an opportunity now exists for the development of a simple registration scheme for ‘micro’ NFPs, which would provide some (but not all) of the benefits of being a separate legal entity, without the compliance obligations and formality of existing legal structures.¹⁶ These otherwise unregulated organisations would then fall within the ambit of a national regulator, and would be subject to simple reporting and not overly burdensome compliance requirements.

As a side issue, we note the Consultation Paper states that 400,000 NFPs may access tax concessions, either via ATO endorsement or by self-assessment, and hence ‘the most comprehensive interaction between the Commonwealth and the NFP sector is through taxation.’¹⁷ While the taxation system provides a potential head of power for federal regulation of the NFP sector, it should be highlighted that this does not mean the ATO currently has ‘interaction’ with 400,000 NFPs. According to the ATO’s 2009/10 Compliance Report the number of NFPs registered with the ATO is around 190,000.¹⁸

5. Charitable trusts

Q5: Should the supervision of charitable trusts be moved from the state Attorney-General’s to a national regulator?

As PilchConnect does not routinely advise on charitable trusts, we propose to address this question briefly.

In broad terms we support a proposal to move the supervision of charitable trusts to a national regulator. The current system is patently *ad hoc* and affords very little regulatory oversight of charitable trusts or their distributions. The lack of information available about charitable trusts frustrates attempts to identify,

¹⁴ See *Corporations Amendment (Corporate Reporting Reform) Act 2010* (Cth).

¹⁵ See PilchConnect’s first submission to Productivity Commission at p 16; PilchConnect’s submission to Victorian Competition and Efficiency Commission at p 10.

¹⁶ In our view, the considerably high number of unincorporated groups indicates that current incorporation structures are not attractive to many small grassroots groups.

¹⁷ Treasury Consultation Paper at [43].

¹⁸ The ATO Compliance Program 2009/10 is available at <http://www.ato.gov.au/corporate/content.asp?doc=/content/00205435.htm&pc=001/005/008/009/002&mnu=&mfp=&st=&cy=1>

monitor and evaluate the contribution of the NFP sector more broadly. One of the major advantages of national regulation would be the establishment of a central repository of information about the activities of the NFP sector, including charitable trusts (see section 9 below).

While we submit that greater monitoring of charitable trusts makes sense (as does consistency amongst state-based regimes), it would be important to ensure supervision and reporting are proportionate and appropriate for the size of the fund.

6. Incorporated Associations

Q6: Should regulation of incorporated associations (including reporting and governance) be moved to a national regulator? Should there be a residual role of the states in regulating incorporated associations?

Consistent with previous submissions, our preferred approach to regulatory reform is for all Australian Governments to agree to establish a national regime for NFP registration with a specialist regulator, if necessary by way of a referral of state powers to the Commonwealth (see also section 12 below). We submit that this approach will achieve major reductions in red tape and complexity for the NFP sector, including the 136,000 incorporated associations in Australia.

A 'one stop shop' model will be less effective than it could be if incorporated associations are not regulated by that one 'shop'. If state-based regulation continues, the establishment of a national regulator could serve to exacerbate the existing multiplicity of regulators for incorporated associations, or at least not result in any real reduction in red tape – for example, associations receiving tax concessions would continue to be regulated at the federal level (for taxation purposes), and at the state level (for incorporation registration).

Under our preferred approach, the states would no longer regulate incorporated associations, however they would continue to play an important role in sector development, similar to the role state governments already play for state-funded (federally regulated) companies limited by guarantee. We see a key residual role for the states in:

- ▶ working with the national regulator to coordinate grant reporting requirements, share information, and develop common standards to promote compliance and good governance, particularly for NFPs that receive state funding, and
- ▶ providing support and incentives to state-based NFPs that encourage innovation, effectiveness and sustainability in the sector.

If, however, our preferred approach is rejected and the states and territories are to maintain a residual role in regulating incorporated associations, then we submit that:

- ▶ there must be emphasis placed on the harmonisation of legislation across jurisdictions. The current situation gives rise to inconsistencies across jurisdictions, and creates complexity for associations who increasingly have (or wish to have) a presence in other states, either physically or with the assistance of new technologies. For this reason we support the general thrust of the Productivity Commission's recommendation for a harmonised approach to the regulation of incorporated associations regime,¹⁹

¹⁹ Recommendation 6.2 of the Productivity Commission (2010) Research Report on the Contribution of the Not-for-Profit Sector (*Productivity Commission Final Report*).

but also highlight that achieving harmonisation and mutual recognition is a lengthy process involving intergovernmental negotiation and consensus-building which could alternatively be directed towards achieving a referral of powers.

- ▶ migration to a national legal structure must be both accessible and simple. For example, incorporated associations should be allowed to migrate to company limited by guarantee structure without the imposition of a registration (or other) fee, and by simple procedures and completion of a user-friendly form.

The extent to which incorporated associations can be brought within a national regulatory framework should be carefully considered, as it has the potential to greatly influence the success of any new national regulator. Of the 136,000 incorporated associations in Australia, we consider the vast majority would be reluctant to voluntarily migrate to another regulatory regime without clear benefits on offer, and a simple method of transfer. By inaction alone, most incorporated associations would be likely to remain under a state or territory regime – an outcome that could undermine the benefits that a national regulator could bring to Australia’s NFP sector.

If, however, a new national regulatory regime (including a ‘one stop shop’ independent NFP regulator) were to present an attractive, tailored and accessible alternative to state-based regimes,²⁰ in our view, existing incorporated associations would be more likely to voluntarily migrate to a new national framework.

7. Tax concessions

Q7: What impacts would simplifying and streamlining mechanisms for the assessment, granting and monitoring of concessional tax treatment have on the NFP sector? In particular, what impacts would this have on small and new NFP entities?

Q8: What are the likely compliance cost savings from improvements to taxation arrangements?

Q9: Does the current complexity of the taxation framework discourage entities from applying to access tax concessions? If so, what elements of the framework are most problematic?

The Consultation Paper posits that access to taxation concessions as a ‘unifying theme’ in the diverse NFP sector.²¹ While we agree that concessional tax treatment is a critical benefit for many NFPs, we wish to point out that not all NFPs access Commonwealth and/or state tax concessions, and the taxation system is far from ‘unified’ in its approach to NFPs.

We refer Treasury to our submissions and recommendations to the Productivity Commission and Henry Tax Review, which draw on PilchConnect’s interaction with the NFP community to conclude that:

- ▶ taxation continues to be a major source of confusion and frustration for many NFP organisations

²⁰ We have expressed concern in previous submissions that the legislative approach to incorporated associations, as it current stands, is inadequate for small, grassroots organisations. For example, recent reforms to the Victorian *Associations Incorporation Act 1981* (Vic) will, amongst other measures, apply parts of the *Corporations Act 2001* (Cth) to the associations regime. The complexity of this approach means it does not work smoothly for local volunteer-run groups with very little support because it requires those involved to be familiar with two separate governing Acts. For further information see PilchConnect’s submission on the Exposure Draft of the *Associations Incorporation Amendment Bill 2010* (Vic) available at <http://www.pilch.org.au/submissions/#4>

²¹ Treasury Consultation Paper at [62].

- ▶ procedures for charitable endorsement are far too complex for many small to medium NFP organisations, which are often the types of organisations that could benefit the most from any form of concession
- ▶ characterisation of valid charitable purposes has become so complex that it is difficult for lay people to make application for endorsement without the assistance of a lawyer with expertise in taxation or trusts
- ▶ the current system no longer has a rational basis for charity and NFP concessions, and in the absence of an independent body to define and apply tax concessions for NFPs, there will continue to be confusion and complexity in this area, and
- ▶ in broad terms, PilchConnect endorses the recommendations made in the *Inquiry into the Definition of Charity 2001* and subsequent reviews that have reiterated the key findings of that inquiry, and fully supports steps to be taken towards the implementation of these earlier findings.

We submit that the Australian NFP sector needs one overall simplified tax concession scheme that is underpinned by a rational basis for the determination of charitable status. As the Productivity Commission concluded, ‘jurisdictional differences in the types of NFP tax concessions and their eligibility and endorsement requirements contribute to a complex, inequitable and inconsistent system’²² and that ‘administering individual concessions can ... be complex and costly.’²³ Taxation concessions should provide support to Australia’s NFP sector, rather than create a barrier by continuing to institute a complex and inconsistent regulatory framework.

At PilchConnect, more than 30 percent of all requests for legal assistance received from Victorian NFPs relate to tax concessions and the application of the tax system to their circumstances. We find that small to medium NFP organisations are routinely uncertain about the taxation framework and confused about how to access concessions, particularly where these require endorsement by the ATO.

In our experience NFPs within a particular ‘class’ can be treated inconsistently in their applications for TCC or DGR endorsement, and as a result obtain access to different tax concessions. We note the Productivity Commission also referred to evidence of inconsistencies in endorsement outcomes.²⁴ Further we have noted the outcomes of some NFP applications for endorsement appear to have been dependent on which local ATO office was applied to, with inconsistency a very real concern amongst NFPs.

The DGR framework is particularly confusing for NFPs and in our view, a major contributor to inefficiencies in the sector. The majority PilchConnect’s tax-related inquiries relate to DGR eligibility, the process of applying for endorsement, and ongoing obligations – all of which differ in subtle ways, depending on the DGR category involved. Nearly all applicants are confused about the terminology and the categories that exist.²⁵ As we argued in our submission to the Productivity Commission, we find that most NFPs are so confused by DGR endorsement that they are forced to seek legal assistance for the application process.²⁶

22 Productivity Commission Final Report at p 163.

23 Ibid.

24 See, eg, references to Family Relationships Centres and Neighbourhood Houses in Productivity Commission Final Report at p 164.

25 We note the Productivity Commission’s suggestion that deductible gift recipient status should be widened to include all tax endorsed charities, potentially via an incremental approach in view of revenue implications (Final Report at pp 178-9). While we agree in principle with this proposal, in relation to the ‘affordability’ point, further information would be needed about whether something is to be ‘taken away’ in exchange for the broader application of DGR. A modernised, statutory definition of charity (see section 17 below) would also assist in analysing the impact of this potential reform.

26 PilchConnect’s first submission to the Productivity Commission at p 16.

Unfortunately, one outcome of such a complex system is that well-resourced NFPs are able to afford expert advice, whereas smaller organisations that may require DGR to stay viable are often unable to access professional assistance.²⁷

Currently NFPs applying for endorsement need to complete a number of different, but similar looking, ATO forms. For example income tax concession and DGR forms are very similar in appearance and have similar content. An application for endorsement as a Public Benevolent Institution can relate to either TCC or DGR status (i.e. same test, same regulator – different forms). NFPs often do not realise that these are in fact separate application processes, which relate to different tax concessional benefits. We submit that substantial compliance cost savings could be made by simplifying and streamlining these tax concessional frameworks and application processes.

For an excellent example of the problems faced by small and medium NFPs in relation to applying for tax concessions, we refer Treasury to the submission of the Human Rights Arts and Film Festival to the Senate Inquiry into the Disclosure Regimes for Charities and Not-for-Profit Organisations.²⁸

While we argue that current taxation arrangements for NFPs are in need of significant reform, we wish to emphasise that the need for such reforms should not be seen as a reason for locating a new NFP regulator within the ATO. On the contrary, many of the current problems experienced by the NFP sector with taxation arrangements point to the undesirability of the ATO as the decision-maker for charity and NFP tax status. We draw Treasury's attention to the NFP sector's strong, repeated and unified objection to the location of a new national regulator within the ATO role, expressed in the numerous reviews and inquiries on the sector over the last decade. While the ATO may have become the 'default' NFP regulator at the Commonwealth level, this is quite manifestly an undesirable situation, and one of the strongest arguments for establishing a new independent NFP regulator – see further section 14 below.

8. Regulation and supervision

Q.10 What value would educational and compliance initiatives managed by a new national NFP regulator provide to NFP entities?

PilchConnect recognises the important role a national regulator could play in facilitating access to information and advice for NFPs. However we do not support a proposal for the national regulator to 'take over' the educational functions currently provided by a range of bodies noted in the Consultation Paper.²⁹ We submit that 'intermediaries' such as peak bodies and sector-based support services are best placed to tailored advice and training to NFPs. PilchConnect therefore recommends that:

- ▶ education and compliance initiatives of a new national regulator be specifically focused around the provision of accessible information, guidance material and technologies to assist NFPs to understand their obligations and interface with the new regulator, and

²⁷ See the National Pro Bono Resource Centre's 2010 National Law Firm Pro Bono Survey which found that "despite the efforts of private law firms and community legal centres, unmet legal need in these areas [DGR and employment law] of practice remains high", (available at www.nationalprobono.org.au)

²⁸ Human Rights Arts and Film Festival submission to the Senate Inquiry:

http://www.aph.gov.au/Senate/Committee/economics_ctte/charities_08/submissions/sub133_pub.pdf

²⁹ Treasury Consultation Paper at [66] and [67].

- ▶ more government funding be made available for sector-based support services to assist NFPs in meeting their compliance obligations and achieving good governance.

In the current NFP regulatory environment, the burden imposed by a myriad of legal structures, uncoordinated reporting requirements and inconsistent fundraising laws is compounded by a dearth of free or affordable information and advice. PilchConnect was established in 2008 to address this need and has, to date, assisted thousands of Victorian community organisations through its legal assistance, education and policy program. In the last financial year, PilchConnect received 440 inquiries, provided telephone advice to 172 NFPs, referred 40 matters to PILCH member law firms for pro bono assistance, and delivered training to hundreds of people involved in Victorian NFP groups.

The Consultation Paper puts forward the idea of a national regulator taking over the role, currently provided by government agencies and non-government bodies, of educating the sector about governance and reporting standards and encouraging compliance with new regulatory requirements. PilchConnect does not support this proposal, broadly, for the following reasons:

- ▶ A national regulator can only provide advice of a general nature. Our experience has shown that NFPs (especially those starting up) benefit from more tailored advice. The Productivity Commission similarly noted the inadequacy of advice currently available to NFPs, which in its view ‘in part derives from a tendency of regulators to provide common rather than tailored advice.’ This can ‘confuse rather than enlighten decisions’.³⁰ Notably, in its final report the Commission concluded that:

*Better advice is emerging from initiatives within the sector, from NFP peak bodies and purpose specific entities. For example, PilchConnect (sub. 131) offers assistance to those involved in community organisations that want to establish a legal entity, be it an incorporated association, a company limited by guarantee, cooperative, or other form.*³¹

- ▶ NFPs are unlikely to have a sufficient degree of trust to discuss their compliance queries with a national regulator which also has enforcement powers. Our experience shows that, by contrast, they do have confidence discussing compliance issues with peak bodies and sector-based services such as PilchConnect. The preference of NFPs to learn from a source they feel they can trust has also been acknowledged by the Productivity Commission.³²
- ▶ Peak bodies and sector-based service providers are also often more in touch with the challenges faced by NFPs such as limited resources and reliance upon volunteers. Sector-based intermediaries have greater insight into the practical realities faced by NFPs and with proper funding could work with the regulator at arm's length, and deliver the educational initiatives listed in the Consultation Paper (e.g. centralised portal of information for NFP entities, web-based training, new guidance materials, phone assistance, and referral services) with greater efficiency and specificity than a national regulator.
- ▶ We note that with the exception of web-based training, PilchConnect is currently providing to Victorian NFPs all the initiatives listed in the Consultation Paper at paragraph 70. With additional

³⁰ Productivity Commission (2009) Draft Research Report on the Contribution of the Not-for-Profit Sector (*Productivity Commission Draft Report*) at 6.10.

³¹ Productivity Commission Final Report at p 122.

³² Productivity Commission Final Report at p 247. See also Part 5 of PilchConnect's follow-up submission to Productivity Commission which details the advantages that sector-based intermediaries enjoy in delivering educational and compliance support to the sector.

funding from government,³³ PilchConnect could continue to develop these educational initiatives with the view to eventually rolling out these services nationally.

Our position (above) has found favour with the Productivity Commission, who rejected the idea that the new national regulator should have a role in sector development. Instead the Commission proposes ‘the national regulator’s responsibilities be limited to those relating to registration and reporting associated with demonstrating compliance with the legal requirements that underpin public trust and confidence in the NFP sector. As such, the [national regulator’s] responsibilities would be focused around NFPs’ legal form and associated reporting requirements, endorsement for tax concessions, and fundraising.’³⁴

We do not submit that sector-based support services should meet all the educational needs of the NFP sector (for example a national regulator should provide clear descriptions of requirements associated with the legal forms it regulates, and guidance on how it will apply laws). However, overall we believe sector-based support services, with proper government support, are better placed to assist NFPs in understanding their regulatory requirements.³⁵

9. Reporting

Q 11: What benefits would a ‘report-once, use-often’ model of reporting offer?

Q 12: What information do NFP entities currently provide to government agencies? Do these include general purpose financial reports and fundraising reports? What other reports are currently required? What do the reporting requirements involve? What information is required for the purposes of grant acquittals?

Q13: How significant is the compliance burden imposed by requirements for acquittal of grants? Where could these be simplified?

Currently there is multiple reporting to multiple regulators, and the information collected is not collated systematically or fed back to the sector to inform service delivery or benchmarking. A key benefit offered by the establishment of an independent regulator is the establishment and maintenance of a centralised reporting portal for NFPs.

The ‘report once, use often’ model, if implemented correctly, has the dual benefit of minimising compliance burdens of NFPs while at the same time enhancing transparency and accountability in the sector. The benefits of the ‘report once, use often’ model have been acknowledged by the Productivity Commission and endorse the Commission’s recommendations on this issue.³⁶

The significant role reporting has in maintaining public trust and confidence in the sector cannot be overlooked. As noted in the Consultation Paper, ‘reporting by NFP entities is an important governance and transparency mechanism.’³⁷ Specific measures that will assist in the ‘report once, use often’ approach are:

³³ PilchConnect has current funding until December 2011.

³⁴ Productivity Commission Final Report at p 117.

³⁵ To this end, PilchConnect welcomes the Productivity Commission’s recommendation that state and territory governments review their full range of support for sector development to strengthen strategic focus, including on developing the sustainable use of intermediaries providing support services to the sector: see Productivity Commission Final Report at p 237.

³⁶ Recommendations 5.3 and 6.6 of the Productivity Commission Final Report.

³⁷ Treasury Consultation Paper at [84].

- ▶ adoption by all Australian governments of the Standard Chart of Accounts;
- ▶ implementation and education for a NFP-specific accounting standard, and
- ▶ development and assisted roll-out of an NFP-specific standard business reporting (SBR) model.

While adequate disclosure is essential to transparency, and ultimately, the integrity of the sector, we submit that reporting should occur on a 'sliding scale' to ensure that small NFPs (in particular grassroots groups) are not required to meet as complex reporting regimes as larger organisations with significant turnover.

Streamlining in reporting can be learned from commercial experiences in policy reform, such as the implementation of the SBR scheme, however it is important that NFP regulation does not simply copy from the for-profit experience. It is critical that reporting requirements for NFPs remain relevant and appropriate to the NFP context. As a matter of principle, the cost of compliance should not exceed the benefit. There is a need to strike an appropriate balance between legitimate public and stakeholder interest in disclosure, on the one hand, and the relative cost (based on the size of the organisation) on the other. This constant theme of better regulation rather than simply imposing additional obligations on the sector is critical to any future reform, as the very worst that can come from this scoping study is an additional layer of bureaucracy without any efficiency benefit to NFPs.

We refer Treasury to the model of reporting used by the UK Charity Commission, where information is lodged on a central portal once a year and used for numerous purposes. In the Australian context, such a portal would allow for links between to federal and state information systems, and could result in considerable cost savings for organisations and government.

In our experience, most NFPs will form the view that it is not that any *one* of its reporting obligations is necessarily unreasonable or burdensome, rather the cumulative effect of multiple obligations of reporting to different regulatory and funding bodies (philanthropic, corporate and/or government) creates unnecessary duplication and wastes precious time and resources. For an account of the various bodies an NFP may typically report to, see PilchConnect's submission to the 2008 Senate Inquiry.³⁸

Grant reporting obligations form a significant part of the burden for many NFPs. There is a lack of consistency in reporting at the various levels of government (federal, state and local). Even within the one level of government, grant reporting requirements differ depending on the type of funding (project, core operational, fee for service) and which government department is administering the funds. We refer Treasury to the governmental reports cited by the Productivity Commission³⁹ which have raised concerns about the efficiency of grant-making. For example the Victorian Government's 2007 Review of Not-for-Profit Regulation reported estimated savings of \$12 million could be made from the streamlining of service agreements and a further \$0.8 million from streamlining of grants.⁴⁰

As the Productivity Commission noted, grant funding is a substantial source of NFPs' income, and regulation associated with and embedded in government service agreements (often seen as 'regulation by stealth') constitute a major course of compliance costs.⁴¹ Despite the burden this places on NFPs, the data submitted to governments is rarely fed back to NFPs to assist them with benchmarking or to inform their service

38 Senate Inquiry Report at p 33.

39 Productivity Commission Final Report at p 291.

40 State Service Authority(2007) Review of Not-for-Profit Regulation - Final Report, available at [http://www.ssa.vic.gov.au/CA2571410025903D/WebObj/NFP_FinalRpt/\\$File/NFP_FinalRpt.pdf](http://www.ssa.vic.gov.au/CA2571410025903D/WebObj/NFP_FinalRpt/$File/NFP_FinalRpt.pdf)

41 Productivity Commission Final Report at p 115; see also p 291.

delivery.⁴² In particular, non-standard acquittal makes the collection and reporting of information time consuming, difficult and costly, and renders the collected data difficult to use for comparative analysis, although the introduction of the Standard Chart of Accounts will greatly assist.

Not only is the acquittal of grants burdensome for NFPs, but many funders also require NFPs to conduct performance reporting. The utility of such reporting was questioned by the Productivity Commission.

While a new national regulator with a 'report once, use often' reporting model has the potential to significantly ease the grant-related reporting burden for NFPs, it will only be effective if government (or other) funding agreements standardise their requirements with this national system. This will require cooperation between all governments and government departments, and should be a continuing priority area for COAG.

Q14: What benefits would the establishment of a NFP sector information portal have for the public, the sector and governments? What information should be available on the portal?

Q15: What information might need to be provided to a national regulator but not made public through a NFP information portal?

The establishment of a NFP sector information portal would increase the capacity of the government to develop policies that better reflect the diverse needs of the sector. As mentioned in the Productivity Commission report, 'governments lack data and knowledge of Australia's not-for-profit organisations and are therefore unable to develop appropriate policies to better regulate them and encourage their formation.'⁴³

Preserving stakeholder confidence is fundamental to the sustainability of NFPs. This means the type of information that is relevant to NFP stakeholders is not the same as for business. NFPs are mission-driven organisations; the information available on the portal should reflect this. For example, people who donate to a support service for disadvantaged youth want to know what services have been provided, how many young people have been helped, how many volunteers and members are involved, where the organisation gets its funding from and so on, as well as basic information about the organisation's financial position. In short, descriptive information about activities and outcomes needs to be considered when regulating NFPs, not just financial information.

Importantly, we recommend such descriptive reporting in the context of a tiered, proportionate reporting scale based on organisational size. The need for transparency and accountability must be balanced with the need for reporting requirements that are reasonable and do not overly burden small groups with limited resources who rely heavily on volunteers.

Discretion and sensitivity must also be adopted by the Regulator when assessing information that needs to be made public through a NFP information portal. Organisations may, through the nature of their work, require certain exemptions. For example, the publication of directors' details for anonymous self help groups may be inappropriate, as would the publication of certain information regarding domestic violence groups. In circumstances such as these, we submit that applications for exemptions be approved or denied at the discretion of the regulator. Such information would then be provided to the national regulator, but not made public through a NFP portal.

⁴² PilchConnect's submission to Senate Inquiry at p 33.

⁴³ Productivity Commission Final Report at p 116.

Q16: What benefits would be provided by the application of SBR to the NFP sector, following the implementation of the SCOA so as to minimise any additional compliance costs?

Q17: Given its voluntary nature, are many NFP entities likely to use SBR? What barriers, such as preferences for providing reports in paper form or reluctance to upgrade accounting software, might reduce usage of SBR by NFP entities?

Technological measures such as SBR have significant potential to reduce reporting compliance costs for NFPs. However it will be important for such technologies to be developed and rolled out in ways that are appropriately tailored to the NFP sector. Simply ‘transplanting’ for-profit systems into the NFP context will not achieve optimal results.

We note the Consultation Paper’s statement that currently businesses (including NFPs) with contemporary SBR-enabled software can lodge a range of financial and payroll returns to a number of state, territory and Australian agencies. However, to our knowledge there has not been significant uptake of SBR technology by the NFP sector to date. While many organisations would undoubtedly benefit from SBR, the required hardware, software and know-how are resources which many NFPs do not have easy access to.

The introduction of SBR technology for the NFP sector would need to be accompanied by a comprehensive information campaign and free or affordable training in how to use it. Alternatives would need to be available to groups that did not have SBR capabilities, as it would be inappropriate if the key benefits of a ‘report once, use often’ model were accessible only to those NFPs that were in a position to implement SBR.

10. Governance, disclosure and compliance

Q18. Are the suggested core rules and regulatory framework adequate?

The Consultation Paper’s reference to ‘core rules’ is confusing and further guidance is required before detailed submissions can be made in relation to their role in NFP regulation, and the impact they would have on NFP governance.

While we agree that the regulator has a key role in the oversight of governance for the NFP sector which could include the endorsement of a best practice regulatory framework⁴⁴, we are concerned that Treasury’s suggested ‘core rules’ do not appear to be consistent with existing legislative and common law duties. It is unclear where duties of ‘compliance’ and ‘prudence’ will fit with existing (possibly overlapping) duties currently imposed on those governing NFPs,⁴⁵ nor is it clear why a ‘fit and proper person’ test should be extended to all NFPs. We submit that while minimum governance standards are important, any ‘core rules’ should be commensurate with the NFP’s activities and size, and not simply add another layer of regulation that causes confusion about well-established governance and accountability standards.

It is currently unclear where these core rules would sit in the governance framework (ie, legislative duties, constitutional requirements, or simply best practice guidelines). In Victoria, reforms to the incorporated association regime will see the introduction of statutory duties imposed on committee members based on

⁴⁴ Treasury Consultation Paper at [102] to [112].

⁴⁵ For example, the Consultation Paper’s reference to ‘duty of prudence’ (see [107]) appears to be separate to the *Corporations Act*’s reference to duty of care and diligence (see s.180).

those contained in the Corporations Act. At a Commonwealth level, these duties are already applied to officers of companies limited by guarantee. The addition of 'core rules' could potentially confuse this.

NFPs are already subject to significant duties and responsibilities. An independent regulator could have a key role in providing guidance on how to practically apply these duties and would be best place to drive reform and policy development in this area if required. If the core rules are intended to be in the form of 'best practice' guidance for NFPs then this could certainly be of practical use to NFP governance, in the same way that ASIC provides guidance on particular aspects of the Corporations Act.

Q19. What powers does the regulator require to improve governance and regulatory oversight?

While PilchConnect supports the creation of a national regulator with real enforcement powers and a presence and influence in the sector, it cautions against the creation of a regulator focused on a deterrence model of regulation that seeks to 'police' the sector.

Unlike companies, NFPs are mission-driven, not profit-driven and are more likely to react to regulation as social actors and responsible citizens. From our experience assisting the Victorian NFP sector, failure to comply with regulatory requirements is seldom motivated by calculated self-interest. Rather, it is the result of a lack of knowledge or confusion about the complexity of the current regulatory regime and how to comply with applicable laws.⁴⁶

Recent comments by the ATO echo our experience that NFPs are generally willing to comply but lack knowledge about what their obligations are:

*Non-profit organisations show a strong desire to get it right, but often have a low level of knowledge about how the tax and superannuation systems work. Where compliance issues arise, they are mainly due to mistakes or a lack of knowledge.*⁴⁷

This experience suggests that if NFPs were operating under a simpler regulatory regime and equipped with appropriate resources and information, the level of voluntary compliance would be high.

The risk of having a regulator that emphasises its enforcement and investigative functions above its consultative and persuasive functions (as has been suggested of ASIC), is that people may be deterred from establishing, managing and operating NFPs for fear of attracting a host of penalties. Given the role that NFPs play in providing vital services to the community and enhancing participation in civil society, it is important to introduce a responsive model of regulation,⁴⁸ whereby the regulator works *with* the NFP sector to promote compliance and best practice.

PilchConnect submits that a new national regulator, like the UK Charity Commission, should be vested with strong legal powers to investigate and intervene where there is strong cause for concern that a NFP's beneficiaries or assets are at risk. However it is also vital the regulator gives NFPs every reasonable opportunity to comply with their legal obligations (with a higher expectation for prompt and full compliance for larger NFPs with paid staff and access to professional advice). This would mean that where an NFP is found to have breached a legal requirement, the initial response should be to educate the NFP about the

⁴⁶ We have found that the majority of Victorian NFPs that contact us are willing and eager to comply with regulation and to be accountable and transparent. See further PilchConnect's submission to Victorian Competition and Efficiency Commission.

⁴⁷ See ATO 2008/2009 Compliance Program at p 63, available at http://www.ato.gov.au/content/downloads/COR_0015516_CP0809.pdf.

⁴⁸ For more information on 'responsive model of regulation' see Treasury Consultation Paper (2007) Review of Sanctions in Corporate Law, available at <http://www.treasury.gov.au/contentitem.asp?Navid=037&ContentID=1182>.

requirement and issue a warning (to encourage compliance). Only where this education/warning fails, should a penalty be considered and enforced.

PilchConnect also submits that proportionality should be a goal for a new national regulator. Similar to the approach adopted by the UK Charity Commission, interventions should be proportionate to the issue and risk of harm involved and take account of the capacity of organisation to comply with requirements for change.⁴⁹

We submit that a national regulator should not be permitted to intervene in disputes within, or between, NFPs with a view to undertaking dispute resolution. We consider that the function of intervening in disputes, particularly internal disputes of NFPs, would be inappropriate and impracticable for a national regulator. We submit that the members involved should be primarily responsible for this process, with sufficient government funding provided to sector-based supports (such as mediation and dispute resolution services) to assist NFPs to deal with grievances. In cases where disputes are protracted, the regulator could have power to appoint a 'statutory manager' if doing so would serve the public interest, such as is the case under Part VIIAB of the Victorian *Associations Incorporation Act 1981*.

11. Fundraising

Q20: What role should a national regulator play with respect to fundraising?

PilchConnect has previously submitted that current inconsistencies between state-based fundraising laws have resulted in duplication and significant expense, as well as being enormously frustrating and confusing. In keeping with previous submissions⁵⁰ we submit that the introduction of a nationally consistent fundraising law will:

- ▶ reduce red tape and, therefore compliance costs
- ▶ reduce the administrative costs on government in regulating fundraising, and
- ▶ result in greater public transparency around the cost of fundraising.

We note that it is clearly no longer a question of if there should be national legislative consistency but of how best this should be achieved. We submit that the required consistency would best be achieved through the introduction of national fundraising legislation, developed following a referral of state powers to the Commonwealth. The new national NFP regulator would be responsible to implementation of the national fundraising regime and implementation of a new legislative framework.

In the absence of a referral of powers, harmonisation of fundraising legislation will be a critical step in removing red tape. We note the current COAG agenda to pursue harmonisation of all state and territory fundraising laws. However, as recent experience demonstrates, harmonisation is, at best, a very lengthy process (we note that it took more than a year for COAG to even 'scope' the need for harmonisation of fundraising laws). We submit that pursuing harmonisation is particularly difficult in the fundraising context

⁴⁹ The UK Charity Commission has adopted a 'light touch' regulatory approach which is operated according to a published risk and proportionality framework. See eg presentation delivered by David Locke, Executive Director of Charity Services, Charity Commission for England and Wales, at McCullough Robertson Lawyers, Brisbane on 16 June 2010.

⁵⁰ See, for example, PilchConnect's submission to 2008 Senate Inquiry at p 28; and PilchConnect's first submission to Productivity Commission at p 15.

because existing laws are considerably divergent, technology is raising new challenges, and the number and diversity of groups to be regulated is large. In this context, we urge Australian governments to demonstrate real commitment to working together in a timely way to achieve greater harmonisation and mutual recognition.

12. Constitutional and jurisdictional issues

Q21: What problems arise from the complex interrelationship between Commonwealth, state and territory responsibilities in this area?

Q22: What might be the implications of the different approaches of referral of powers or harmonisation of legislation?

The current mix of regulators and interplay between state and federal legislation applicable to the NFP sector is clearly unsatisfactory. In our view, the greatest hurdle in the establishment of an independent national regulator for the NFP sector is the division of responsibilities between federal and state governments.

We submit the preferable method for national regulation is by a referral of powers from the states to the Commonwealth, which would enable the introduction of national legislation for NFP regulation⁵¹ including the establishment of an independent regulatory body.

We appreciate that there is a high level of political cooperation required to achieve a referral of powers. However the development of corporate law (in the for-profit context) shows that the states can quickly be harnessed into action to endorse a nation approach when necessary, and without undermining their ongoing roles. The NFP sector is worthy of similar prompt cooperation from all levels of government.

However, even in the absence of a referral of powers, we submit there are interim or 'fall back' measures which can be taken by the Federal Government to significantly improve the current system. For example, we urge the Government to implement the Productivity Commission's recommendation for the introduction of an additional chapter in the *Corporations Act* to deal specifically with NFPs.⁵² We submit that the new part should include:

- ▶ a plain English guide for NFPs and model constitutions that NFPs can choose to modify or adopt
- ▶ lower fees and penalties, based on a sliding scale according to size
- ▶ no fee for migrating from a state- or territory-based legal structure to a company limited by guarantee, and

We see no reason why this new part of the *Corporations Act* could not be administered by an independent regulator, which could draw on the data collection systems of ASIC. Improvements to the *Corporations Act* would make the company limited by guarantee structure more attractive to NFPs, and over time may lead to state-based incorporated groups migrating to the national structure, especially if it were seen as offering

51 We refer Treasury to PilchConnect's submission to the 2008 Senate Inquiry (at [8.4], p 28) where we discuss how legislative reform which implements a new, national NFP legal structure could be best achieved. We remain of the view that the preferable method is a referral of powers to the Commonwealth enabling the introduction of a new Commonwealth NFP-specific Act (covering legal structure and fundraising) in conjunction with another Commonwealth Act establishing a new independent national regulator.

52 Recommendation 6.1 of the Productivity Commission Final Report.

significant benefits (such as streamlined reporting to a ‘one stop shop’ regulator) and existing legal/financial barriers to migration were removed.

More broadly, consistent with our responses above, if the states are not willing (at least in a timely fashion) to refer any necessary powers over incorporated associations and fundraising to the Commonwealth, harmonisation is an alternative (yet not ideal) option and would at least allow for improved ability for NFPs to operate or fundraise interstate with greater certainty. We agree with the overall thrust of the Productivity Commission’s recommendations that Australian governments, through COAG, pursue harmonisation of key aspects of incorporated association and fundraising legislation across all states and territories.⁵³

A ‘best practice’ incorporated association model and fundraising law enacted uniformly under state/territory laws would eliminate many of the inconsistencies and complexities currently faced by the sector. However as discussed above, recent experience demonstrates that harmonisation is, at best, a very lengthy process, and involves intergovernmental negotiation and consensus-building which we submit could alternatively be directed towards achieving a referral of powers.

13. Form of national regulator

Q23: What form of the national regulator best meets the objectives of simple, effective and efficient regulation of the NFP sector?

Q24: Would a Commonwealth only regulator provide sufficient benefits to the sector?

We submit the independence of the regulator is critical. PilchConnect strongly endorses the Consultation Paper’s statement that ‘an independent national NFP regulator would provide the greatest benefits to the public, the sector and to governments, in terms of reducing red tape and simplifying and streamlining reporting arrangements.’⁵⁴ If the Federal Government is of the view (consistent with a number of recent reviews and inquiries noted in the Paper) that this is the best option, we urge the Government to bypass the ‘interim measures’ canvassed and cut to the chase by establishing a new national body to act as a national regulator of NFPs.

We submit an independent regulator should have the following features to ensure public trust, confidence and accountability in the NFP sector and the national regulatory framework:

- ▶ the Registrar/Commissioner should be appointed and removed by the Governor-General
- ▶ have a fixed term (5-7 year) appointment
- ▶ report to a Minister for the Not-for-Profit Sector or the Prime Minister
- ▶ be required to table an annual report to each House of Parliament
- ▶ have funding allocated by Parliament.

⁵³ Recommendations 6.2 and 6.3 of Productivity Commission Final Report.

⁵⁴ Treasury Consultation Paper at [131].

We acknowledge that a new independent regulator would require significant resources – an under-resourced body would make the present situation even worse. However as we noted in submissions to the Senate Inquiry and Productivity Commission, cost savings would be achieved in a transition from multiple state-based regulators and extra ATO staff. Further savings may be available by utilising online data collection (eg. via SBR-style technologies) and ‘piggybacking’ on regional office networks and data management systems developed by ASIC (while retaining independence).⁵⁵ We also note that establishment of a new national body would result in cost savings for the states, who would be freed from a registration and compliance role that is not revenue earning.

On the issue of a ‘Commonwealth only’ regulator, we refer to our submissions in sections 6 and 12 above. Fundamentally, any reforms to the NFP regulatory framework must be assessed against the overarching principle that the cost of compliance should not exceed the benefit. As previously discussed, the benefits of a ‘one stop shop’ model will be less than they could be if only a minority of NFPs are regulated by it, and/or if regulated NFPs still have to report to other regulators.

That said, we consider there is merit in establishing a national regulator that can regulate NFP entities that are already under Commonwealth jurisdiction (ie. companies limited by guarantee, entities endorsed for tax concessions). As discussed in section 6 and 12 above, the national regulator’s scope could then be expanded once the benefits of national regulation are more widely acknowledged.

In section 12 above, we noted measures that could be taken by the Federal Government to increase the attractiveness of a Commonwealth regulatory regime to NFPs, namely:

- ▶ the introduction of a specialist NFP legal structure, or failing that, amendments to the *Corporations Act* to insert a new chapter dealing specifically with NFPS / companies limited by guarantee
- ▶ the removal of fee- and resource-related disincentives to incorporation as a national NFP structure, and
- ▶ removal of barriers to the migration of incorporated associations to a national legal structure.

In our view, these measures, if implemented effectively, could result in a large number of new NFPs incorporating as (and existing NFPs migrating to) a national legal structure to take advantage of the benefits of the ‘one stop shop’ option.

None of these measures require referral of powers or a high levels of political cooperation between Australian governments – they simply require the introduction of ‘market-based’ incentives to encourage NFPs to opt for a Commonwealth NFP framework and the removal of existing disincentives for state-based NFPs.

14. Interim regulator

Q25: Are there benefits from establishing an interim regulator through an existing Commonwealth regulator, to undertake immediate reform?

We submit that an independent national regulator is central to any reform initiatives. For this reason we cannot support the creation of an ‘interim’ regulator within the ATO or ASIC as canvassed in the

⁵⁵ See PilchConnect’s submission to the 2008 Senate Inquiry at pp 23 and 33-35.

Consultation Paper.⁵⁶ We refer Treasury to our previous submissions to numerous inquiries and reviews, where we (and others) have strongly advocated for an *independent* regulatory body to oversee the NFP sector.

By way of summary, we submit that:

- ▶ The ATO and ASIC are institutionally entrenched in regulating in the ‘for-profit’ context. Their overarching philosophies, objectives and approaches are deeply incompatible with the effective regulation of the voluntary sector.
- ▶ Both the ATO and ASIC are focused on enforcement and are known to rigorously investigate and prosecute contraventions. The NFP sector needs a more non-threatening regulator that understands their mission-driven nature and can provide practical assistance to comply with regulatory obligations, using enforcement powers as necessary in serious cases (such as fraud).
- ▶ Regulation of NFPs would be a minor part of the ATO’s or ASIC’s overall functions. An independent regulator, with a specific mandate and direct funding from Parliament, would result in a better system of NFP regulation and increase public trust and confidence in the sector.

We note in particular that every major inquiry and report delivered to government over the last a decade⁵⁷ has commented on the undesirability of the ATO as the regulator of NFPs. In particular:

- ▶ The ATO’s primary role is to administer taxation laws to protect the national revenue base. There is a fundamental conflict between this role, and the ATO’s role in determining eligibility for tax concessions that ultimately reduce the national revenue. It is entirely inappropriate for the ATO to be the decision-maker of NFP charitable status given inherent responsibilities to protect revenue. This has been acknowledged by various reports, most recently in Productivity Commission’s final report which recommended that ‘at a minimum, endorsement of Commonwealth tax concessions for NFPs that are currently undertaken by the ATO should be undertaken by the [new national regulator].’⁵⁸
- ▶ The ATO’s conflict of interest is real and systemic; it cannot be dismissed as a mere ‘risk’ of a ‘perceived’ conflict between the ATO’s revenue focus and its role as NFP regulator. The structural and branding measures proposed by the Consultation Paper (at [138]) do not address the underlying conflict issue, nor do they acknowledge the shared knowledge systems (philosophical, technical and technological) that a new NFP regulator would be required to operate in if it were established within the ATO.
- ▶ The ATO has demonstrated a historical and philosophical tendency to make decisions which limit the scope of taxation concessions, thereby maximising the national tax revenue.⁵⁹ This approach is not

56 There are, however, a range of measures which we submit should be taken by the Federal Government to improve the current situation – see in particular our submissions in section 12 above.

57 See 1995 Industry Commission Inquiry into Charitable Organisations in Australia (see eg discussion at 8.2 and recommendation 27); 2001 Inquiry into the Definition of Charities and Related Organisations (recommendations 25 and 26); 2008 Senate Inquiry (recommendation 3); Henry Tax Review (recommendation 41).

58 Productivity Commission Final Report at p 145.

59 See eg *Aid/Watch Incorporated v Commissioner of Taxation* [2010] HCA 42 (1 December 2010) and *Commissioner of Taxation v Word Investments Ltd* (2008) 236 CLR 204. More generically, the ATO’s Compliance Report, which provides a ‘snapshot’ of annual compliance activities relating to NFPs, focuses almost on actions which resulted in an increase to tax revenue and/or the refusal or revocation of NFP tax concessions. For example in relation to NFP income tax-related compliance, the 2010/11 Report states that the ATO ‘reviewed entitlement to tax concessions of 200 non-profit organisations... [resulting] in liabilities raised of almost \$2 million’; reviewed ‘4,100 applications for refunds of franking credits with 125 applications varied down, protecting over \$11 million in revenue’; and checked

surprising given the ATO's primary role as tax collector, however we submit it is an inappropriate and undesirable situation.

- ▶ The ATO has expertise in charitable and NFP law *insofar as they relate to the taxation treatment of NFPs*.⁶⁰ Effective regulation of the NFP sector is not simply an issue of taxation. The overarching principles of regulation must be kept in mind. These include promoting public trust and confidence in the sector by establishing a national framework focussed on ensuring good governance, transparency and accountability. These goals are much broader than the scope of the ATO's current regulation of the 190,000 odd NFPs endorsed for taxation concessions.
- ▶ The ATO, quite properly, operates on a system which prioritises strict confidentiality of taxpayer information. This approach is inconsistent with the proposed functions of a national NFP regulator which would have key responsibilities in relation to the collection and public dissemination of information about regulated NFPs. In these areas ASIC has considerably more expertise and systems than the ATO.
- ▶ We understand that the ATO itself does not want the role. Indeed, the ATO has expressed the view that NFP administration would be better served by a single, independent common point of decisions-making on definitions of charitable or non-profit status.⁶¹

The Consultation Paper suggests that 'if the regulator were initially established within another agency or as an independent statutory body, the ATO would maintain its current role in the regulation of the NFP sector.'⁶² We oppose this approach and submit the ATO's function should be limited to applying tax concessions to those organisations that are *independently* determined as falling within the relevant taxation categories, and taking action where there is a suspected contravention of taxation laws. A key benefit of a national regulator would be the independent determination of charitable status of NFPs.

The Consultation Paper points to Canada as a potential model for a regulator housed within the tax authority.⁶³ There has been much criticism, however, of the approach and functioning of the Charities Directorate in Canada's tax authority.⁶⁴ Further, we note that Canada has not had the same experience as Australia with regard to a national 'for-profit' corporate regulatory framework. To our knowledge there are very few, if any, independent reports from overseas jurisdictions with comparable systems of government that have recommended the establishment of a new NFP regulatory body within the tax authority.

There is some concern that establishing a separate, independent regulator would take such a long period of time that an interim measure is required. In this regard we note that the New Zealand Charities Commission was established by the *Charities Act* in 2005, and its register opened two years later in February 2007.⁶⁵ Obviously there are a number of challenges faced in Australia (such as the federal system of government) but it does point to the ability to implement change relatively swiftly if the political will is there.

almost 5,300 applications for endorsement as a charity or deductible gift recipient, with over 700 disallowed.' See ATO's 2010/11 Compliance Program available at <http://www.ato.gov.au/corporate/content.asp?doc=/content/00248103.htm&page=1&H1>

60 We note Treasury's arguments for initially establishing a new national regulator within the ATO include that 'the ATO has the greatest Commonwealth expertise in charitable and NFP law': see Consultation Paper at [140].

61 See ATO submission to the 2001 Charity Definition Inquiry at p 1, available at http://www.cdi.gov.au/html/public_submissions.htm.

62 Treasury Consultation Paper at [140].

63 Treasury Consultation Paper at [139].

64 See eg Drache, A. and Hunter, W.L, 'A Canadian Charity Tribunal: A Proposal for Implementation' (2000) 5(4) *The Philanthropist* 3; Phillips S.D, 'Canada: Civic Society Under Neglect' (2010) 23(1) *The Philanthropist* 65.

65 See Productivity Commission Final Report at p 149.

Whatever approach is taken, it is clear that the regulator will need to be *sufficiently resourced* to achieve its mandate. A poorly resourced regulator would potentially make the current situation worse. The regulator must be appropriately equipped to undertake activities that allow it to gain strong public support, as its success will be underpinned by public trust and confidence.

15. Sector specific regulation

Q26: What would be the advantages and disadvantages of incorporating the functions of ORIC and the proposed housing regulator into a national regulator? What alternative approaches are available to avoid duplication?

Q27: What benefits could flow from a national regulator maintaining a dedicated subsection focusing on Indigenous corporations and/or housing?

Given our limited exposure to ORIC and the groups regulated by it, and the proposal to establish an NFP housing regulator, we are not in a position to comment in detail on these questions. However we urge the government to seek further input from relevant stakeholders (including Indigenous corporations and groups proposed to fall within the housing regulator).

In particular, we are of the view that additional measures should be taken by government to facilitate proper consultation with Indigenous groups potentially affected by (or with an interest in) this proposal to subsume the functions of ORIC within a new NFP regulator. We note the Consultation Paper was released in late January 2011 and afforded little over a month to respond. This timeframe has made it difficult for many stakeholders to submit a response. Indigenous peoples – especially those located in remote areas – may require more time and different methods of providing feedback in order to meaningfully engage with the issues canvassed in the Consultation Paper.

16. Funding implications

Q28: What level of contribution should NFP entities make to the cost of the national NFP regulator?

Q29: Should there be a differential cost for smaller NFP entities?

PilchConnect acknowledges that the creation of an independent regulator will require a net increase in government funding (e.g. for a one-off establishment costs), however, given the enormous contribution of the sector,⁶⁶ we believe this expenditure is entirely justified.

As we have previously submitted, the expense of establishing and providing ongoing funding to properly resource an independent NFP regulator can be minimised by:

- ▶ utilising the experience and resources of ASIC in online data collection, storage and searching
- ▶ cost sharing with the states and territories because of savings achieved by no longer needing separate regulators in each jurisdiction

⁶⁶ The Productivity Commission reports that the NFP sector contributes over 4 % of GDP, with an additional \$14.6 billion of unpaid work contributed by nearly 5 million volunteers: see Productivity Commission Final Report at p 3.

- ▶ cost savings achieved by fewer staff required in the ATO (their role would be to administer tax concessions rather than determining eligibility), and
- ▶ costs savings to NFPs by a reduction in compliance-related red tape, resulting in greater efficiencies in service delivery by NFPs on behalf of government and public funded services.

In addition, we submit that it would be appropriate for a national regulator to be partly funded through a co-contribution from NFPs, provided that such cost recovery is structured on a sliding scale according to size. For example, filing fees should be modest, and NFPs with small turnover should only pay minimal fees, if any at all. We believe that further work needs to be done to find the most appropriate thresholds in light of the size of organisations currently on ASIC and state-based registers.

17. Definitional issues

Q30: Would a statutory definition of charity achieve the goals of greater certainty and administrative efficiency in relation to the determination of charitable purpose, particularly in relation to determining access to taxation concessions and across different jurisdictions and laws?

Q31: Is Parliament a more appropriate body to define charitable status than the courts, given its ability to be more responsive to changing community needs and expectations?

A statutory definition of charity is long overdue, having been considered in detail in the 2001 Inquiry into the Definition of Charities and Related Organisations (**2001 Charity Definition Inquiry**), and subsequently endorsed by multiple reviews and inquiries. In 2010 alone, there were two major Government reviews that have recommended the adoption a statutory definition of charity (in line with the 2001 Charity Definition Inquiry), in conjunction with the establishment of an independent regulatory body with sector-wide responsibilities.⁶⁷

In our experience, the current common law definition of ‘charitable purposes’ is archaic and confusing. The NFP sector spends a substantial amount of time and incalculable funds (including on legal advice) trying to understand whether they fit into certain categories and in some instances inappropriately skewing their activities to do so.⁶⁸

Currently, the ATO is the *de facto* regulator in determining which NFPs qualify for charitable and/or DGR status, whereas at state level the processes for determining charitable status vary significantly, with little coordination among agencies. While a modernised statutory definition is recommended, we note that the *impact* of this change will depend to a large extent on how it is linked with taxation concessions.

A definition of charity is only as good as the method it is interpreted, hence the importance of having an independent regulator to apply the definition, free from the perception of political influence. There is an inherent conflict in allowing the ATO to continue this function of determining charitable status given its ongoing function of protecting Australia’s revenue base. In our submission, an independent, national regulator is best placed to oversee the introduction of a new statutory definition of charity.

⁶⁷ See recommendations 6.5 and 7.1 of Productivity Commission Final Report; recommendation 41 of the Henry Tax Review.

⁶⁸ See Productivity Commission Final Report at p 164.

The courts will always have a role in defining charities, however in our submission that role should be minimal and only called upon when the scope of the definition is called into question. The UK Charity Commission's test cases on charitable status demonstrate that courts still have a role in UK, however this has been lessened by the legislative definition and regulator's proactive stance on providing certainty and clarity.

Successive reviews have recommended a statutory definition of charity. The key is the application of that definition – this is where the independence of a regulator is critical and why we hold the firm view that the regulator should be a separate entity from existing government agencies. If, in the interim, this is not possible, it is better placed as a separate organ of ASIC as opposed to the ATO given the inherent conflict of interest (whether real or perceived) that would arise.

Appendix A: Previous PilchConnect submissions

Along with many other NFPs, PilchConnect has contributed a significant amount of its limited resources (currently only 3 lawyers) to preparing submissions on NFP regulatory reform. In the last two and a half years we have made 14 public submissions and 3 confidential submissions to 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	
2010: ASIC Consultation Paper on Related Party Transactions	http://www.pilch.org.au/submissions/#1
2010: Victorian Competition and Efficiency Commission (VCEC) Inquiry into Victoria's regulatory framework	http://www.pilch.org.au/submissions/#2
2010: Submission to the Commonwealth Treasury — reforms to company limited by guarantee reporting requirements	http://www.pilch.org.au/submissions/#3
2010: Submission to Senate Economics Legislation Committee — Tax Laws Amendment (Public Benefit Test) Bill 2010	http://www.pilch.org.au/submissions/#3
2010: Submission to CAV — Exposure Draft Associations Incorporation Amendment Bill	http://www.pilch.org.au/submissions/#4
2009: Submission to CAV - Regulatory impact Statement on the Associations Incorporation Amendment (Fees and Other Matters) Regulations 2009	RIS available via Consumer Affairs Victoria website submission available on request.
2009: Further Submission to Productivity Commission, — Draft Research report, 'Contribution of the Not-for-profit-Sector'	http://www.pilch.org.au/submissions/#6
2009: Initial submission to Productivity Commission — Issues paper, 'Contribution of the Not-for-profit-Sector'	http://www.pilch.org.au/submissions/#6
2009: Submission to Victorian Government — Reducing Red Tape Project, Early Childhood Development Sector Consultation	http://www.pilch.org.au/pastsubmissions/#2
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/pastsubmissions/#4
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/pastsubmissions/#5
2008: Submission to Economic Development and Infrastructure Joint Investigatory Committee of the Victorian Parliament — Inquiry into Improving Access to Victorian Public Sector Information and Data	http://www.pilch.org.au/pastsubmissions/#6
2007: Submission to State Services Authority — Review of Not-for-Profit Regulation	http://www.pilch.org.au/pastsubmissions/#9
2007: Submission to Victorian Government — Stronger Community Organisations Project (SCOP)	http://www.pilch.org.au/pastsubmissions/#10