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EFFECTIVE GOVERNANCE STRUCTURES FOR CHARITIES AND NOT FOR PROFITS: ACNC REQUIREMENTS AND MORE

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Author
Andrew Lind, Director
Andrew.Lind@corneyandlind.com.au

Level 4, Royal Brisbane Place
17 Bowen Bridge Rd Herston Q 4029
Phone: (07) 3252 0011
Fax: (07) 3257 7890
www.corneyandlind.com.au

EFFECTIVE GOVERNANCE STRUCTURES

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1 THE ACNC

- 1.1 The principal piece of legislation is the *Australian Charities and Not-for-Profits Commission Act 2012 (the "Act")*.¹
- 1.2 The Act establishes a new regulator for the sector, the *Australian Charities & Not-for-Profits Commission ("ACNC")* to act as the point of first registration of Charities and then the regulator of compliance or otherwise of registered charities.
- 1.3 The reach of the ACNC is to "charities" only at this point in time being entities that qualify under the common law meaning of charity², namely not for profit public benefit bodies whose purpose is:
 - 1.3.1 The advancement of education;
 - 1.3.2 The advancement of religion;
 - 1.3.3 The relief of poverty; or
 - 1.3.4 Other purposes beneficial to the community.³
- 1.4 The intention is that the reach of the ACNC may eventually extend to all Not for Profits (whether charities or not) including sporting clubs for example.

¹ For convenience in this paper references to section numbers without further reference are references to sections in the Act.

² A statutory definition of Charity is proposed to apply from 1 January 2014. This paper will not consider that proposed definition.

³ The meaning of Charity in Australia has consistently been affirmed by our courts as deriving from the Statute of Elizabeth[i] and the decision of the Privy Council in *Commissioners for Special Purposes of the Income Tax v Pemsel [ii]*. The majority of the High Court affirmed this in 2008 in *Commissioner of Taxation of the Commonwealth of Australia v Word Investments Ltd. [iii]*

[i] 43 Eliz I c 4 (*Charitable Uses Act 1601*).

[ii] [\[1891\] UKHL 1](#); [\[1891\] AC 531](#) at 581-582

[iii] [\[2008\] HCA 55](#) at para. 78

2 WHAT DO WE MEAN BY “GOVERNANCE?”

- 2.1 ACNC: “[G]overnance is the process, activities and relationships that make sure your organisation is effectively and properly run.”⁴ Yes; however when management is in place, governance does not equal management.
- 2.2 Some helpful distinctions:
- 2.2.1 Governance: Minds | Management: Hands
- 2.2.2 Governance: Strategy | Management: Implementation
- 2.3 Those distinctions only take us so far – there is still too much room for a ‘very blurry line’ between:
- 2.3.1 one hand the domain of the *Board / Council / Management Committee*;
- 2.3.2 on the other the domain of *Management* – often the paid staff of the organisation.
- 2.4 When the ACNC talks of *governance*, it has the Board in primary view but as we will see, senior management is also in view.
- 2.5 In larger organisations senior management will be expected to exercise some of the *governance* function (to the extent that it has been properly delegated by the Board).

3 ACNC GOVERNANCE STANDARDS

- 3.1 New governance standards are **intended to apply to all charities regardless of entity type** unless a specific limited exemption applies. More later on the limited exemptions.
- 3.2 The Explanatory Statement⁵ (to the proposed governance standards regulations) provides the context and reasons for these governance standards:
- 3.2.1 Section 200-5 of the Act provides that the Governor-General may make regulations, prescribing matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.
- 3.2.2 Subsection 45-10(1) of the Act provides that the Regulations may specify standards (the **governance standards**) which an entity must comply with in order to become

⁴ *Governance for Good: The ACNC’s guide for charity board members*. Find it at: http://www.acnc.gov.au/ACNC/manage/tools/ACNC/edu/tools/GFG/GFG_Intro.aspx

⁵ <http://www.comlaw.gov.au/Details/F2013L00402/Explanatory%20Statement/Text>

registered under the Act and to remain entitled to be registered under the Act.
(emphasis added)⁶

- 3.2.3 The purpose of the Regulation is to amend the *Australian Charities and Not-for-Profits Commission Regulation 2013* to specify governance standards which registered entities must comply with in order to become registered under the Act and to remain entitled to be registered under the Act.
- 3.3 Then from the proposed regulations - *The governance standards support registered entities in fulfilling their objectives by providing a minimum level of assurance that they meet community expectations in relation to how a registered entity should be managed. (Reg 45.1)*

4 GOVERNANCE STANDARDS – WHERE AND WHEN?

- 4.1 They will form part of the *Australian Charities and Not-for-Profits Commission Regulations*.
- 4.2 The amendments to the Regulations to enshrine the Governance Standards have been drafted in amendments to the Regulations.
- 4.3 *Australian Charities and Not-for-Profits Commission Amendment Regulation 2013 (No. 1)* – [Location: <http://www.comlaw.gov.au/Details/F2013L00402>]
- 4.4 The Governance Standards amending regulations were tabled in the House of Representatives and the Senate on 12 March 2013.
- 4.5 They are **intended to commence on 1 July 2013**.
- 4.6 A motion was put before the Senate on 21 March 2013 by Senator Fifield to disallow these regulations.
- 4.7 Either house now has 15 sitting days to disapprove/disallow the regulations, failing which they will commence on the following day or 1 July 2013, whichever is the later.⁷

⁶ I will add emphasis during this paper without referring to it everytime.

⁷ S45-20 of the Act and Reg 2 of *Australian Charities and Not-for-Profits Commission Amendment Regulation 2013 (No. 1)*. There is a school of thought that positive debate has to occur on the regulations for them now to be deemed passed. This is perhaps a moot point. The assumption that this paper will
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5 ACNC - NEW TERMINOLOGY AND NEW MEANING TO OLD TERMINOLOGY

- 5.1 Before we look at the governance standards in some detail we need to look at some relevant key terms.
- 5.2 The ACNC Act introduces some new terms that we need to be familiar with:
- 5.2.1 **“Registered entity”** means an entity registered under the Act, that is a registered charity. (s300-5)
- 5.2.2 **“Responsible entity”** (s300-5 and 205-3)
- a Directors (if the registered entity is a company);
 - b Trustees or directors of a corporate trustee (if the registered entity is a trust);
 - c Administrators (trustee in bankruptcy, receivers and liquidators and the like).
- 5.2.3 **“Company”** means both a body corporate and an unincorporated association. (s205-10)
- 5.2.4 **“Director”** means:
- a For incorporated bodies - an appointed director (and defacto director);
 - b For non-incorporated bodies – an appointed member of the management committee (or defacto). (s300-5)
- 5.2.5 **“Entity”** means any of the following:
- a an individual;
 - b a body corporate;
 - c a body politic;
 - d any other unincorporated association or body of persons;
 - e a trust. (s205-5)
- 5.2.6 **“Federally regulated entity”** is:
- a a constitutional corporation; or

make is that the regulations will be amended as they are currently drafted to incorporate the governance standards.

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- b a trust, all of the trustees of which are constitutional corporations; or
- c a body corporate that is taken to be registered in a Territory under section 119A of the *Corporations Act 2001*; or
- d a trust, if the proper law of the trust and the law of the trust's administration are the law of a Territory; or
- e an entity, the core or routine activities of which are carried out in or in connection with a Territory. (s205-15)

5.2.7 “**Constitutional corporation**” means a corporation to which paragraph 51(xx) of the Commonwealth Constitution applies or a body corporate incorporated in a territory. (s205-20)

51(xx) of the Commonwealth Constitution:

The Parliament shall, subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth with respect to:

(xx) foreign corporations, and trading or financial corporations formed within the limits of the Commonwealth

For Charities – it will generally be the “trading corporation” power that is relied upon.

A corporation is not limited to a company registered under the *Corporations Act 2001*. It will include any entity with status as an artificial person, having its own capacities, rights and liabilities which are distinct from those of its members (Justice Murphy, *Queen v Federal Court of Australia; Ex Parte WA National Football League* (1979) 143 CLR 190 at 239 (Adamson’s Case)).

Therefore, a corporation will include an incorporated association and company limited by guarantee.

What does ‘trade’ mean?

The Courts have consistently refused to define ‘trade’. It is to be treated as an ordinary word, and not a term of art (*State Superannuation Board v Trade Practices Commission* (1982) 150 CLR 282).

Barwick CJ commented that: “trade for constitutional purposes cannot be confined to dealing in goods or commodities. Its full parameters may be difficult of definition. But the commercial nature of an activity is an element in deciding whether the action is in trade or trading (Adamson’s Case, page 209). In that case, selling tickets to a football match was deemed to be trade.

Trading includes selling services, know-how, investment advice etc.

A university, providing education to fee paying students, was held to be engaging in trade (*Quickenden v O’Connor* 109 FCR 243).

What degree of trade is necessary?

In 1974, the High Court, by a narrow majority, held that a corporation would be a 'trading corporation' if the purpose for its creation was to engage in trading (*R v Trade Practices Tribunal; Ex Parte St George County Council* (1974) 130 CLR 533). This was a narrow test that required an examination of the articles of association creating the corporation, to determine whether its purpose was to trade.

In 1979, the High Court re-visited the issue (Adamson's Case). The majority now preferred an 'activities' test'. Rather than considering the 'purpose' of the corporation, the question became, "is trading a substantial corporate activity at the time the question is asked?" Barwick CJ noted that, "once it is found that trading is a substantial and not merely a peripheral activity not forbidden by the organic rules of the corporation, the conclusion that it is a trading corporation is open" (at page 208). Mason J commented that "when trading activities form a sufficiently significant proportion of the overall activities, it is a trading corporation" (at page 233).

The fact that trading is incidental to other activities (such as education, religion or sporting activities) will not prevent it being a trading corporation. It does not need to be the dominant activity. It just cannot be insubstantial (per Murphy J, Adamson's Case, at page 239).

In *E v Australian Red Cross Society* (1991) 27 FCR 310, Justice Wilcox, in finding that the Royal Prince Alfred Hospital was a trading corporation, noted that it received \$14 million in patient fees and \$4 million from business activities. This was dwarfed by the Government subsidy of \$112 million. However, the payment of \$18 million per year from trading (15.78%) could only be regarded as substantial, and therefore it was a trading corporation.

Similarly, in *United Firefighters Union of Australia and Others v Metropolitan Fire and Emergency Services Board* [1998] 83 FCR 346, the Fire and Emergency Services Board received only 5.11% (\$8 million) of its income from trading activities. Even though it represented a small part of the Board's overall activities and income generation, it was still considered a substantial corporate activity, resulting in the Fire and Emergency Services Board being considered as a trading corporation.

It may of course be open for some Charities (e.g. churches) to properly argue that they are not "trading corporations".

5.2.8 "Senior Management" [my term] an individual other than a responsible entity:

- a who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the registered entity; or
- b who has the capacity to affect significantly the registered entity's financial standing; or
- c in accordance with whose instructions or wishes the responsible entities of the registered entity are accustomed to act (excluding advice given by the individual in the proper performance of functions attaching to the individual's professional

capacity or his or her business relationship with the responsible entities of the registered entity). (s85-10(3))

6 WHO IS TO BE BOUND BY THE ACNC GOVERNANCE STANDARDS?

This Division [Division 45—Governance standards] sets up a system to allow the creation of minimum governance standards that entities are required to meet (in order to become registered, and on an ongoing basis). (s45-1)

*This Division achieves that object by setting up a system to allow the regulations to specify standards with which **an entity must comply** in order to become registered under this Act, and to remain entitled to be registered under this Act. (s45-2(2))*

Note 1: The main consequence of failure to comply with these standards is a loss of the entity's entitlement to registration. If the entity is a federally regulated entity, such a failure to comply may also result in enforcement action under Chapter 4.

Note 2: For the consequences of registration, see section 20-5.

Note 3: A registered entity must notify the Commissioner of significant non-compliance with these standards that results in the entity no longer being entitled to be registered (see section 65-5).

- 6.1 Registered **entities** with the ACNC, that are *federally regulated entities* are themselves bound by the standards, no matter what its type. Currently that is only constitutional corporations, trusts with constitutional corporations as trustees and other entities governed by a law of a Territory.
- 6.2 **Responsible entities [directors]** of federally regulated entities by virtue of the power of the ACNC to suspend and remove responsible entities of federal regulated entities when the ACNC reasonably believes that the registered entity has not complied with a governance standard, or that it is more likely than not that the registered entity will not comply with a governance standard. (s100-5)
- 6.3 Senior **Managers** of federally regulated entities by virtue of the ACNC's power to give directions to such managers when the ACNC reasonably believes that the registered entity has not complied with a governance standard or that it is more likely than not that the registered entity will not comply with a governance standard. (Sub-division 85-B)

7 EXEMPTIONS

- 7.1 Basic *Religious Charities* are relieved from complying with the Governance Standards. (s45(5))
- 7.2 It is beyond the scope of this paper to consider who are and who might not be Basic Religious Charities (BRC) (which is defined in s205-35). However those who might be able to take advantage of this categorisation need to carefully consider it and also be aware that such a categorisation may be lost if for example the BRC financially reports as it were not a BRC.
- 7.3 The Governance Standards must not effectively amount to *gag clauses* preventing entities from advocating for change in government policy. (s45(6))

8 PROPORTIONATE APPLICATION? YES - BUT HOW?

From the proposed Regulations:

45.1 Simplified outline—how the governance standards apply

The governance standards support registered entities in fulfilling their objectives by providing a minimum level of assurance that they meet community expectations in relation to how a registered entity should be managed.

Community expectations in relation to governance may include expectations about how a registered entity goes about managing its affairs, the use of public monies, volunteer time and donations provided to it, how the entity manages the risks that it faces, how the entity promotes the effective and responsible use of its resources and how the entity goes about demonstrating that it is operating transparently and for a proper purpose.

The steps a registered entity will need to take to comply with the governance standards will vary according to its particular circumstances, such as its size, the sources of its funding, the nature of its activities and the needs of the public (including members, donors, employees, volunteers and benefit recipients of the registered entity).

*The compliance obligations, processes and reasonable steps specified in the governance standards are to be interpreted having regard to the objects of the Act and the matters the Commissioner must consider in exercising the Commissioner's powers as listed in section 15-10 of the Act (in particular, the principles of regulatory necessity, **reflecting risk and proportionate regulation**, as well as the unique nature and diversity of not-for-profit entities and the distinctive role that they play in Australia).*

The objects of the Act are: to maintain, protect and enhance public trust and confidence in the Australian Not-for-Profit sector; to support and sustain a robust, vibrant, independent and innovative Australian Not-for-Profit sector; and to promote the reduction of unnecessary regulatory obligations on the Australian Not-for-Profit sector.

The governance standards also act as a mechanism which may enliven the enforcement powers in Part 4-2 of the Act to help protect and sustain the Not-for-Profit sector and maintain and enhance public trust and confidence.

- 8.1 It's not that some of the standards do not apply to small charities, it's that the "expectation bar will be higher" the larger your charity. This will not help with clarity.

9 GOVERNANCE STANDARD 1 – PURPOSES AND NOT FOR PROFIT NATURE OF A REGISTERED ENTITY

Object

(1) The object of this governance standard is:

(a) to commit a registered entity, its members and its responsible entities to the registered entity's purposes; and

(b) to give the public, including members, donors, employees, volunteers and benefit recipients of the registered entity, confidence that the registered entity is acting to further its purposes.

Standard

(2) A registered entity must:

(a) be able to demonstrate, by reference to the governing rules of the entity or by other means, its purposes and its character as a Not-for-Profit entity; and

(b) make information about its purposes available to the public, including members, donors, employees, volunteers and benefit recipients; and

(c) comply with its purposes and its character as a Not-for-Profit entity.

Note: Information in relation to the purposes of a registered entity would be available to the public if it appears on the Australian Charities and Not-for-Profits Register or in an Australian law on www.comlaw.gov.au or www.austlii.edu.au, or is otherwise made available on request.

9.1 Governing **rules** is defined by s300-5 as follows:

governing rules, of an entity, means written rules that:

- a *govern the establishment or operation of the entity; and*
- b *can be enforced against the entity.*

9.2 “*Governing rules*” certainly include your Constitution (or Trust Deed). Other documents that could be caught:

9.2.1 By-Laws

9.2.2 Charters (of Board committees for example)

9.2.3 Policies?

9.3 “*Not-for-Profit*” is not a charity law concept. In the Queensland Law Society submission on the draft Governance Standards our Not-for-Profit Law Committee said this:

“... [T]he expression ‘Not-for-Profit’ is not a charity law concept. Charity law is concerned with purposes. It is the “charitable” or otherwise “community-serving purpose”, not technical adherence to Not-for-Profit distribution constraints, or member exclusion from benefit, that is important to the concept of “charity”. The standard might be more usefully reframed as focused only on purpose – that is, ensuring that the purpose of the organisation is fulfilled, rather than requiring a particular form (Not-for-Profit) to be adopted.”

9.4 Self check: Do your governing rules clearly express your charitable purposes and (based on the current Standard) do they have a prohibition on distribution of profits to members?

9.5 Your *Constitution* will form part of the public information portal to be maintained by the ACNC (available free of charge to any member of the public). The disclosure of your Constitution to the ACNC with the *Form AB* is at this point voluntary. If you are currently going through a

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Constitutional review (as a number of our charitable clients are) our suggestion is that you hold disclosure until the tidied up version is in place.

10 GOVERNANCE STANDARD 2 – ACCOUNTABILITY TO MEMBERS

Object

(1) *The object of this governance standard is to ensure the accountability and transparency of a registered entity to its members.*

Standard

(2) *A registered entity that has members must take reasonable steps to ensure that:*

(a) *the registered entity is accountable to its members; and*

(b) *the registered entity's members have an adequate opportunity to raise concerns about the governance of the registered entity.*

Note 1: The steps that a registered entity may take to ensure that it is accountable to its members could include:

(a) *holding annual general meetings; and*

(b) *providing members with an annual report (including financial information and achievements towards its purpose); and*

(c) *providing for elections for its responsible entities.*

Note 2: The steps that a registered entity may take to ensure its members have an adequate opportunity to raise concerns could include:

(a) *holding an annual general meeting with a question and answer session; and*

(b) *providing an opportunity for members to propose resolutions and to vote upon those resolutions.*

Note 3: When taking the reasonable steps required by governance standard 2, regard must be had to requirements of the governing rules of the registered entity, to the extent that those governing rules include appropriate accountability mechanisms. If those governing rules include appropriate accountability mechanisms, compliance with those rules would demonstrate compliance with governance standard 2.

Note 4: Subdivision 60-C of the Act sets out rules about the preparation of annual financial reports.

10.1 “**Member**” is to be defined in amendments to the Regulations - **member** has the meaning given by the Income Tax Assessment Act 1997 (Reg 4).

10.2 INCOME TAX ASSESSMENT ACT 1997 - SECT 960.130

Members of entities

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(1) The following table sets out who is a member of various entities.

<u>Members</u>		
<u>Item</u>	<u>Entity</u>	<u>Member</u>
1	<u>company</u>	a <u>member</u> of the <u>company</u> or a stockholder in the <u>company</u>
2	<u>partnership</u>	a <u>partner</u> in the <u>partnership</u>
3	trust (except a * <u>corporate unit trust</u> or a * <u>public trading trust</u>)	a beneficiary, unitholder or object of the trust
4	* <u>corporate unit trust</u>	a unitholder of the trust
5	* <u>public trading trust</u>	a unitholder of the trust

- 10.3 Query: How does this work for Charitable Trusts? Do beneficiaries now have standing to hire and fire the trustees?
- 10.4 Even for Charities with memberships, there is a philosophical argument about whether these matters should more appropriately be left to the members themselves? That is, is it more appropriately a matter for the members to be insisting on this accountability rather than the ACNC?
- 10.5 Practically this standard may have a counter productive effect of encouraging Charities to consider operating with a narrower membership.

11 GOVERNANCE STANDARD 3 – COMPLIANCE WITH AUSTRALIAN LAWS

Object

(1) *The object of this governance standard is to give the public (including members, donors, employees, volunteers and benefit recipients of a registered entity) trust and confidence that a registered entity is governed in a way that ensures its on-going operations and the safety of its assets, through compliance with Australian laws (including preventing the misuse of its assets).*

Note: Compliance with Australian laws sets a minimum benchmark by which all entities should govern themselves. A failure by a registered entity to comply with an Australian law puts the public (including members, donors, employees, volunteers and benefit recipients of the registered entity) at risk and, therefore, governance standard 3 allows the Commissioner to take a proportionate approach to:

- (a) protect public trust and confidence; and*
- (b) protect the assets of the registered entity; and*
- (c) ensure that the registered entity continues to operate in a manner that is sustainable and consistent with its purposes.*

Standard

(2) A registered entity must not engage in conduct, or omit to engage in conduct, if the conduct or omission may be dealt with:

(a) as an indictable offence under an Australian law (even if it may, in some circumstances, be dealt with as a summary offence); or

(b) by way of a civil penalty of 60 penalty units or more.

Note 1: See section 4AA of the Crimes Act 1914 for the current value of a penalty unit.

Note 2: Governance standard 3 does not extend Australian law to overseas jurisdictions. An Australian law may already extend to an overseas jurisdiction by other means.

Note 3: While a registered entity must comply with all Australian laws, a serious infringement of an Australian law covered by governance standard 3 may allow the Commissioner to exercise his or her enforcement powers under Part 4-2 of the Act, following consideration of the matters mentioned in subsection 35-10 (2) of the Act.

11.1 Note 2 was added after a number of submissions were made about the difficulty this Standard would cause for Charities operating in overseas jurisdictions.

11.2 Concern: This Standard allows the ACNC to act pre-emptively, even before formal charges may have been made and certainly before any conviction is recorded. I query how the rule of law, the presumption of innocence and procedural fairness is served by the standard being able to be breached if the ACNC believes that an offence has occurred? I hasten to add that the ACNC would in all probability act cautiously.

12 GOVERNANCE STANDARD 4 – SUITABILITY OF RESPONSIBLE ENTITIES

Object

(1) The object of this governance standard is to maintain, protect and enhance public trust and confidence in the governance and operation of a registered entity.

Standard

(2) A registered entity must:

(a) take reasonable steps to ensure that each of its responsible entities meet the conditions mentioned in subsection (3); and

(b) after taking those steps:

*(i) be, and remain, satisfied that each responsible entity meets the conditions;
or*

(ii) if it is unable to be, or remain, satisfied that a responsible entity meets the conditions, take reasonable steps to remove that entity.

Note 1: Other Australian laws may require responsible entities to be replaced, if removed, because a registered entity may need to have a minimum number of responsible entities.

Note 2: The reasonable steps required of a registered entity may include:

(a) obtaining declarations from responsible entities and searching public registers on appointment; and

(b) obtaining a commitment from a responsible entity that, if its circumstances change, it will advise the registered entity.

(3) Subject to subsection (5), the conditions for each responsible entity are that:

(a) it is not disqualified from managing a corporation, within the meaning of the Corporations Act 2001; and

(b) it is not disqualified by the Commissioner, at any time during the preceding 12 months, from being a responsible entity of a registered entity under subsection (4).

Note: Other Australian laws may place other limitations on who may be the responsible entity of a registered entity, or a particular type of registered entity.

(4) The Commissioner may disqualify an entity from being eligible to be a responsible entity for the purpose of this governance standard if:

(a) the entity has been previously suspended, or removed, under Division 100 of the Act as a responsible entity of a registered entity; and

(b) the entity has been given notice of its disqualification by the Commissioner; and

(c) the Commissioner reasonably believes that the disqualification is justified having regard to the objects of the Act.

Note 1: The secrecy provisions in Part 7-1 of the Act prohibit ACNC officers (including the Commissioner) from disclosing protected ACNC information unless the disclosure is authorised by the Act. This prohibits the ACNC from disclosing information about ongoing investigations about particular responsible entities that may be subject to compliance with governance standard 4.

Note 2: The effect of a disqualification lasts for no longer than 12 months from the day a notice is issued by the Commissioner (see paragraph (3)(b)).

(5) Despite subsection (3), the Commissioner may allow an individual to be a responsible entity for a particular registered entity if the Commissioner believes it is reasonable to do so in the circumstances.

(6) An entity that is dissatisfied with a decision of the Commissioner to disqualify the entity under subsection (4) may object to the decision in the manner set out in Part 7-2 of the Act.

12.1 In general terms this Standard seems reasonable. Charities must however consider their Governing Rules and take advice on amending those rules to cover:

12.1.1 Firstly, that “responsible entities” [directors] are obliged to report disqualifying factors;

- 12.1.2 Secondly, provide for another basis of removal being suspension or removal by the ACNC.
- 12.2 If you have ex-officio members of your Board by virtue of employment roles thought will need to be given to the amendment of employment contracts to contemplate a circumstance where the ex-officio Board member may be suspended or disqualified from holding office by the ACNC. The implication for both the Board role and the continuing employment need to be considered.

13 GOVERNANCE STANDARD 5 – DUTIES OF RESPONSIBLE ENTITIES

Object

- (1) *The object of this governance standard is:*
- (a) *to ensure that the responsible entities of a registered entity conduct themselves in the manner that would be necessary if:*
 - (i) *the relationship between them and the entity were a fiduciary relationship; and*
 - (ii) *they were obliged to satisfy minimum standards of behaviour consistent with that relationship; and*
 - (b) *to give the public, including members, donors, employees, volunteers and benefit recipients of a registered entity, confidence that the registered entity:*
 - (i) *is acting to prevent non-compliance with the duties imposed on responsible entities; and*
 - (ii) *if non-compliance with the duties imposed on responsible entities occurs—will act to identify and remedy non-compliance with the duties imposed on the entity.*

Standard

- (2) *A registered entity must **take reasonable steps to ensure** that its responsible entities **are subject to, and comply with,** the following duties:*
- (a) *to exercise the responsible entity's powers and discharge the responsible entity's duties with the degree of care and diligence that a reasonable individual would exercise if they were a responsible entity of the registered entity;*
 - (b) *to act in good faith in the registered entity's best interests, and to further the purposes of the registered entity;*
 - (c) *not to misuse the responsible entity's position;*
 - (d) *not to misuse information obtained in the performance of the responsible entity's duties as a responsible entity of the registered entity;*
 - (e) *to disclose perceived or actual material conflicts of interest of the responsible entity;*

Note: A perceived or actual material conflict of interest that must be disclosed includes a related party transaction.

(f) to ensure that the registered entity's financial affairs are managed in a responsible manner;

(g) not to allow the registered entity to operate while insolvent.

Note 1: Governance standard 5 sets out some of the more significant duties of responsible entities. Other duties are imposed by other Australian laws, including the principles and rules of the common law and equity.

Note 2: Some of the duties imposed by other Australian laws may require a responsible entity to exercise its powers and discharge its duties to a higher standard.

Note 3: For paragraph (f), ensuring that the registered entity's financial affairs are managed in a responsible manner includes putting in place appropriate and tailored financial systems and procedures.

The systems and procedures for a particular registered entity should be developed having regard to the registered entity's size and circumstances and the complexity of its financial affairs.

The systems and procedures may include:

(a) procedures relating to spending funds (for example, the approval of expenditure or the signing of cheques); and

(b) having insurance that is appropriate for the registered entity's requirements.

(3) For paragraph (2)(e), a perceived or actual material conflict of interest must be disclosed:

(a) if the responsible entity is a director of the registered entity—to the other directors (if any); or

(b) if the registered entity is a trust, and the responsible entity is a director of a trustee of the registered entity—to the other directors (if any); or

(c) if the registered entity is a company—to the members of the registered entity; or

(d) in any other case—unless the Commissioner provides otherwise, to the Commissioner, in the approved form.

Note 1: **Company** is defined in section 205-10 of the Act, to include a body corporate or any unincorporated association or body of persons (but not a partnership).

Note 2: Paragraph (c) applies in situations where paragraph (a) cannot apply, for example, if there is only one director or all the directors have a similar conflict.

Note 3: Part 7-6 of the Act provides for the approval of forms.

Note 4: A responsible entity may disclose a conflict of interest in the form of a standing notice with ongoing effect.

(4) If the responsible entity's conduct is consistent with Subdivision 45-C, the responsible entity is taken to have complied with the duties mentioned in subsection (2).

(5) In this section:

insolvent has the meaning given by subsection 95A (2) of the Corporations Act 2001.

- 13.1 Query: What reasonable steps are required to ensure that responsible entities are subject to, and comply with the duties?
- 13.2 Thought will need to given to how “responsible entities” are made subject to the duties? Perhaps they need to be set out in your governing rules. For some charities, for example unincorporated associations thought will need to given as to whether inclusion in the governing rules ‘binds’ the Responsible entities.
- 13.3 Then thought will need to given to processes around ensuring that responsible entities comply with the duties and what sanctions are available in your governing rules for non-compliance.

14 SUBDIVISION 45-C—PROTECTIONS UNDER GOVERNANCE STANDARD 5

The following new regulations are also proposed as protections under governance standard 5:

45.100 Reasonable steps taken to ensure compliance with duties

If a responsible entity meets a protection mentioned in this Subdivision, the registered entity is taken to have taken all reasonable steps to ensure that its responsible entities have complied with the duties set out in section 45.25.

45.105 Protection 1

*(1) A responsible entity meets this protection if the responsible entity, in the exercise of the responsible entity’s duties, **relies on information, including professional or expert advice, in good faith, and after the responsible entity has made an independent assessment of the information**, if that information has been given by:*

- (a) an employee of the registered entity that the responsible entity believes on reasonable grounds to be reliable and competent in relation to the matters concerned; or*
- (b) a professional adviser or expert in relation to matters that the responsible entity believes on reasonable grounds to be within the individual’s professional or expert competence; or*
- (c) another responsible entity in relation to matters within their authority or area of responsibility; or*
- (d) an authorised committee of responsible entities that does not include the responsible entity.*

(2) In determining whether the responsible entity has made an independent assessment of the information or advice, regard must be had to the responsible entity’s knowledge of the registered entity and the complexity of the structure and operations of the registered entity.

45.110 Protection 2

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(1) A responsible entity meets this protection if the responsible entity makes a decision in relation to the registered entity, and the responsible entity meets all of the following:

- (a) the responsible entity makes the decision in **good faith for a proper purpose**;
- (b) the responsible entity does not have a material personal interest in the subject matter of the decision;
- (c) the responsible entity informs itself about the subject matter of the decision, to the extent the entity reasonably believes to be appropriate;
- (d) the responsible entity rationally believes that the decision is in the best interests of the registered entity.

Note 1: Protection 2 is also referred to as the “business judgement rule”.

Note 2: Protection 2 relates to the duty mentioned in paragraph 45.25(2)(a).

(2) In this section:

decision means any decision to take, or not take, action in relation to a matter relevant to the operations of the registered entity.

45.115 Protection 3

A responsible entity meets this protection if:

- (a) at the time when the debt was incurred, the responsible entity had reasonable grounds to expect, and did expect, that the registered entity was **solvent** at that time and would remain solvent even if it incurred that debt and any other debts that it incurred at that time; or
- (b) the responsible entity took all reasonable steps to prevent the registered entity from incurring the debt.

Note: Protection 3 relates to the duty mentioned in paragraph 45.25(2)(g).

45.120 Protection 4

This section is satisfied if, because of illness or for some other good reason, a responsible entity could not take part in the management of the registered entity at the relevant time.

14.1 I have no comments on these protections other than a caution not to assume that the protections are in precisely the same terms as the similar protections in the *Corporations Act 2001*.⁸

15 SUBDIVISION 45-D - TRANSITIONAL ARRANGEMENTS

45.130 Exemption until 1 July 2017

⁸ They were not in the same form in the ‘draft regulations’. I have not done the detailed comparison in the Regulations that are before the House.

Governing rules

(1) *If the governing rules of a registered entity, as in effect on the day this Regulation is registered, **prevent the registered entity from complying with a requirement of Subdivision 45-B**, the registered entity is exempt from the requirement until 1 July 2017.*

(2) *However, **the registered entity must comply with the requirements of Subdivision 45-B as far as is possible, without breaching its governing rules.***

State or Territory law

(3) *If:*

(a) *a registered entity is an incorporated association that is subject to a law of a State or Territory in respect to incorporated associations; and*

(b) *that law sets out duties of responsible entities to the registered entity; and*

(c) *the registered entity and each of its responsible entities is complying with that law;*

the registered entity is taken to be complying with governance standard 5.

(4) *Subsection (3) ceases to have effect in relation to a registered entity if the relevant provisions of the law of the State or Territory is amended so that it:*

(a) *sets out duties for responsible entities that are the same as those in governance standard 5; or*

(b) *otherwise adopts the content of governance standard 5.*

(5) *Subsection (3) ceases to have effect in relation to all registered entities on 1 July 2017.*

- 15.1 This provision should not be taken as a license not to review your *governing rules* (against these Governance Standards) until the beginning of 2017 as there are going to be challenges in interpreting and applying sub-sections (1) and (2).

16 SUBDIVISION 45-E - DISQUALIFIED RESPONSIBLE ENTITIES REGISTER

45.150 Disqualified Responsible Entities Register

(1) *The Commissioner must maintain a register, to be known as the Disqualified Responsible Entities Register, in which the Commissioner must include the following information:*

(a) *the name of entity disqualified by the Commissioner from being a responsible entity of a registered entity, under subsection 45.20(4);*

(b) *the date that the entity was disqualified by the Commissioner;*

(c) *whether the disqualification remains subject to review, under Part 7-2 of the Act.*

(2) *The Disqualified Responsible Entities Register must be maintained by electronic means.*

(3) *The Disqualified Responsible Entities Register must be made available for public inspection, on a website maintained by the Commissioner.*

Note 1: The secrecy provisions in Part 7-1 of the Act prohibit ACNC officers (including the Commissioner) from disclosing protected ACNC information unless the disclosure is authorised by the Act. This prohibits the ACNC from disclosing information about ongoing investigations about particular responsible entities that may be subject to compliance with governance standard 4.

Note 2: The Commissioner may remove an entity from the Disqualified Responsible Entities Register if the entity ceases to be disqualified. See governance standard 4 for how the Commissioner disqualifies an entity.

17 A CHANGE OF GOVERNMENT – MAY SEE THE ACNC GOVERNANCE STANDARDS UNWOUND

17.1 A recent speech by *Kevin Andrews the Shadow Minister for Families, Housing and Human Services* outlined the following:

17.1.1 *A Federal Coalition Government would restructure the Australian Charities and Not for profit Commission into a smaller educative and training body returning its regulatory powers to the ATO and ASIC after the election.*

17.1.2 *... the Australian Charities and Not-for-profits Commissioner has been vested with a range of powers to interfere in and remove responsible office-bearers in a manner that is unprecedented. As it stands, the government is still yet to satisfactorily make out the mischief it sees as warranting such extraordinary overreach.*

17.1.3 *... we will support a small organisation as an educative and training body. We will work with the sector to ensure that it represents the sector. We will work with the sector to transfer responsibility and governance of the Commission to the sector over the next few years.*

17.1.4 *We will return the regulatory powers that existed in the ATO, ASIC and other similar bodies to those bodies.*

17.2 The speech is reproduced by Probono Australia at:
http://www.probonoaustralia.com.au/news/2013/04/future-acnc-under-federal-coalition?utm_source=Pro+Bono+Australia+-+email+updates&utm_campaign=732b661e19-News_30_April4_30_2013&utm_medium=email#

18 BOARD GOVERNANCE / MANAGEMENT GOVERNANCE

- 18.1 The Board is the body responsible for governance.
- 18.2 In larger organisations, some 'governance tasks' are delegated by the full board to:
- 18.2.1 Committees of the Board; and
 - 18.2.2 In some cases - Management.
- 18.3 In my experience the delegation of 'governance tasks' to **management** almost always results in angst as the line between governance and management becomes blurred. Better to call it governance, simply management.
- 18.4 Board Committees work well as long as the following are in place:
- 18.4.1 Committee Charter / rules;
 - 18.4.2 Clarity in the *Committee Charter / rules* about what decisions can a committee make and what must be remitted to the full Board;
 - 18.4.3 Committee Reports are considered and adopted by the full Board.
- 18.5 A Board committee structure helps a Board remain focused on keys governance areas. Common committees in the NFP / Charity space are:
- 18.5.1 *Finance & Audit.* We are seeing 'risk and compliance' move out of this area as that becomes an area in and of itself.
 - 18.5.2 *Governance.* While all of this is governance, this committee will typically deal with matters such as reviews of CEO, New Board Members, CEO succession, Strategic planning (and often anything that doesn't fit anywhere else).
 - 18.5.3 *Risk & Compliance.* Risk audits, Insurance, Health & Safety audit responses, Blue Card audit, ACNC reporting.
 - 18.5.4 *Members standing.* New members and membership issues.
- 18.6 By allowing your committees to include some non-Board members this becomes an effective way of testing the suitability of people for potential roles on the Board.
- 18.7 Limited points of reporting (ideally one – the CEO) between the board and Management will help preserve the roles and assist a well meaning Board from keeping its nose out of management.

19 BOARD STRUCTURE OBSERVATIONS – STAKEHOLDER / EXPERT?

- 19.1 In my observation, good boards are those who are thoroughly *personally engaged* with the charitable purposes of the organisation.
- 19.2 Personal *engagement* = both a deep philosophical connection with the purpose of the charity and ideally a long self-giving history of substantially contributing to that purpose.

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- 19.3 If all board members should be personally engaged, then perhaps they are all *stakeholders*.
- 19.4 Experts must be personally engaged. If not, even if the role is a paid role, their participation will be academic, minimalistic and short lived. Stability resulting from significant tenure at Board level is highly desirable.
- 19.5 Skills mix on a board is of course important but what is even more important is personal engagement.
- 19.6 Charities often ask me if they need a lawyer on their board? My response is – only if the right person also happens to be a lawyer. I then say, that a business person who is experienced in dealing with legal issues (and lawyers) and who is highly personally engaged with the charity may be a better person than a lawyer who is not personally engaged.

20 MAJOR DONORS ON BOARDS

- 20.1 Major donors may or may not be highly personally engaged with the purposes of the charity. Normally major financial support would be a 'sign post' of strong personal engagement but of course don't assume this.
- 20.2 Get to know your major donor over time before a Board role is even contemplated. Engage them in other ways, for example various task groups (like fund raisers) or even a Board Committee.
- 20.3 If donor dollars come with a request for a board role that is of course 'red flag' that they are not the right person.
- 20.4 A risk factor for major donors is that they will very naturally want to trace the effectiveness of their donor dollars and so will be tempted to intermeddle in management.
- 20.5 Do donations come with conditions about manner of application rather than for the general purposes of the charity? If so, this may be a 'sign post' that the donor will seek to use 'Board power' to direct the organisation to her/his preferred initiatives rather than what might be in the best interests of advancing the charitable purpose.
- 20.6 Narrow donor co-dependency relationships are also a risk. Board meetings may become 'fund raisers' rather than meetings focused on good governance.

21 SIZE OF BOARD & ELECTION APPOINTMENT OF BOARD MEMBERS

Board

- 21.1 Minimum = 3 unrelated persons in order for the charity to be sufficiently "public".
- 21.2 Maximum? This really depends on how active the Board Committee system is. The more active the committee system the larger the Board could be. Without an active committee system and a large Board, board meetings will become impossibly bogged down.
- 21.3 I have seen Boards of up to 12+, coupled with an active committee system, function very effectively.

- 21.4 The Board having the ability to directly appoint a small sub-set of the Board members (without having to go to the members of the charity) allows a Board to introduce “new blood” and skill sets and have the new appointee get to know the membership over time.

Membership

- 21.5 Membership is of course separate to Board and they are usually the ones who appoint the Board. It is an urban myth that Charities have to have large numbers of members. Yes they have to be sufficiently *public* but relatively small groups of unrelated persons (who may also correspond with the Board) are sufficient.
- 21.6 There is a decline in public engagement with ‘membership’ and attending AGMs. Those engaged with your charity want to be engaged in other ways. If they are not members, don’t call them members.
- 21.7 Automatic retirement at each AGM? If you do this then my suggestion is that this be for part of the Board only and that those who do retire are eligible for re-election. Stable long tenure boards are important for the charitable sector. This of course is to be balanced against the need for “new blood and fresh thinking”. If the role is a paid role (which would be the exception) then more attention needs to be given to “new blood and fresh thinking” and maximum terms.

22 ACCOUNTABILITY

- 22.1 The *ACNC public information portal* is about driving accountability. It is based on the premise that ‘the best disinfectant is sunlight’.
- 22.2 This will mean that information about the Charity (financial and constituent) is easily publicly available, for free, to all who may be interested – members, donors, service recipients, and the public at large.
- 22.3 Some Charities seek to use, “*Boards of Reference / Advisory Boards*” as an extra group of high level thinkers to whom the charity seeks to make itself accountable. The success or otherwise of these is really driven by the level of engagement with this process. I suggest that a slightly larger Board with an effective ‘broadened’ committee system is a better governance mechanism.
- 22.4 Greater accountability is achieved via a membership larger than the Board, coupled with all Board members facing re-election at set intervals of time, provided that those members are actively engaged in the charity.

Questions?