

MOORESLEGAL

Submission

*Australian Charities and Not-
for-profits Governance
Standards - Draft*

15 February 2013

1. Introduction

Moore's Legal is an Australian law firm with a team that practices exclusively in the area of Not-for-profit ("NFP") law and governance and advises a wide range of organisations in the NFP sector.

This submission is based on our understanding of the history, policy, case law and client needs of the NFP sector and the application of NFP law.

We thank The Treasury for the opportunity to comment on the discussion paper.

2. General Comments

We are concerned about the regulatory duplication for the Australian Charities and Not-for-profits Commission ("ACNC") and the Australian Taxation Office ("ATO") for registered charities that apply for charity tax concessions.

In the following table, we have set out the overlapping duplication in the requirements under the Australian Charities and Not-for-profits Commission Act 2012 ("ACNC Act"), the draft governance standards ("the standards") and the Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012 ("in Australia" Bill").

Subject	ACNC Act	The standards	"In Australia" Bill
Not-for-profit	s.25-5(3) - "The conditions are as follows: (a) the entity is a not-for-profit entity"	Standard 1(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 ... (c) comply with its purposes and its character as a not-for-profit entity."	s.50-50(1) – "An entity covered by item ... is not exempt from income tax unless it: (a) is a * not-for-profit entity."
Purpose	Column 2 of s.25-5(5)- "Entity with a purpose that is the relief of poverty, sickness or the needs of the aged..."	Standard 1(2) - "A registered entity must: (c) comply with its purposes and its character as a not-for-profit entity."	s.50-50(3) – "The entity must... (b) apply its income and assets solely for the purpose for which the entity is established."

Subject	ACNC Act	The standards	“In Australia” Bill
Finances		Standard 4(2) - “A registered entity must take reasonable steps to manage its financial affairs in a responsible manner.”	s. 50-50(3) – “The entity must... (b) apply its income and assets solely for the purpose for which the entity is established.”
Compliance with purpose		Standard 1(2) - “A registered entity must... (c) comply with its purposes and its character as a not-for-profit entity.”	s. 50-50(3) – “The entity must: (a) comply with all the substantive requirements in its governing rules... ”

While the ACNC will be responsible for determining whether a registered entity complies with the Act and the standards, the ATO will be responsible for determining whether the entity complies with the conditions in the “in Australia” Bill.

We are concerned that having multiple regulators determining the same issues will result in a waste of resources (on the part of the charities and the regulators), and we are concerned that it could result in contradictory decisions.

To overcome these problems, we **recommend** that the overlapping conditions in the “in Australia” Bill be stated only to apply to entities that are not registered with the ACNC. We also make the general **recommendation** that the consultation paper provides extensive guidance on how the governance standards are intended to apply. We **recommend** that this material be included in an explanatory memorandum or equivalent accompanying the introduction of the standards into the Australian Parliament.

3. Governance standard 1 - purposes and character of an NFP entity

3.1 Requirement to demonstrate NFP “character”

We query the inclusion of the requirement to demonstrate the NFP “character” of an entity. What does this mean? It is open to subjective interpretation - for example might revenue-raising (“commercial”) activities be regarded as polluting the “NFP character” of an entity?

We **recommend** the removal of the reference to “character as a not-for-profit entity” on the basis that it is vague and that it is not necessary to stipulate it in the standards as it is required elsewhere at law – including the Act itself.

3.2 The existing law

Apart from the “character” element, the standard's usefulness is perhaps mostly for the sake of completeness, given that there is already a requirement to have a not for profit purpose, and to comply with it. The requirement to make the purpose available to the public is perhaps a new requirement but should not be problematic.

The existing law allows the establishment of an entity “for public charitable purposes” generally. It does not require the charity to stipulate one or more specific charitable purposes. However, we are concerned that the standard could be interpreted and administered in future to require a charity to specify a particular sub-type, which would be a new requirement that extends the obligations of charities beyond the current law. It could create problems for existing trusts (particularly testamentary trusts).

We **recommend** that the standard be amended to ensure that it is sufficient that a charity demonstrates the existence of a charitable purpose according to the law of charity.

3.3 Recommendations

In light of our above-stated recommendations, we suggest that standard 1 be amended as follows (additions in italics):

Standard 1

(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*;

...

(c) comply with its purposes *and its character as a not-for-profit entity*.

Note: If a charity’s governing rules provide that it is established for public charitable purposes, this is sufficient to meet the requirement of standard 2(a).

4. Governance standard 2 - accountability to members

The discussion begs the question of who the members are. There is considerable ambiguity on this point.

4.1 Different membership categories

In our experience many NFPs will structure their organisation with different categories of membership. Some categories of membership will have voting rights, others will not.

Often, the right to vote is attached to other rights, obligations, duties or responsibilities. For example, a common one is a requirement to pay an annual membership fee. In other cases, there are a wide variety of stakeholders, volunteers, beneficiaries, and donors whose membership rights are commensurate with the level of involvement and commitment to the NFP. Also, sometimes organisations create “associate membership” categories for members who are under 18 years of age and are not permitted to vote.

We **recommend** that the standard is expressed to apply only to members with voting rights.

4.2 Narrow membership

It is not uncommon for the membership and board of an NFP to comprise the same persons. We understand from comments made at one of the ACNC national community presentation sessions that the standard is not intended to prevent this practice. However, it is not stated in the document itself.

Accordingly, we **recommend** that the standard include a note that states that a registered entity may have the same persons as members and directors.

Incidentally, we note that there can be sound policy reasons for allowing an NFP to operate with the same persons as members and directors. For example, a public benevolent institution may have numerous arms with different responsibilities such as the delivery of disability services, housing services, mental health services and so on. The board of the public benevolent institution may wish to establish a separate corporate entity as a subsidiary to carry on the housing services. The establishment of a separate entity may be necessary for risk management and asset protection purposes. In this case, the directors of the public benevolent institution may act as both the members and the directors of the housing services subsidiary in order to ensure that the housing services subsidiary functions as an integrated arm of the public benevolent institution.

4.3 Entities incorporated by statute

The application of this governance standard to corporations established by statute is not clear. In particular, how does the standard apply to a trusts corporation which is established with “members” who in practice perform the role of “directors”, but who ultimately are accountable to a broader, unincorporated religious association.

We **recommend** that the application of the standard to corporations established by statute be reviewed and clarified.

4.4 Trusts and other entities without members

To make the standards more accessible, we **recommend** that the standard includes a note giving examples of the types of entities that do not have members, for example, trusts.

4.5 Shareholders

We also **recommend** that the standard specify whether the term “member” includes shareholder in the case of a public company limited by shares, or a proprietary limited company. Although these are not common structures for not-for-profit entities, they do exist.

5. Governance standard 3 - compliance with Australian laws

We **recommend** the deletion of this standard on the basis that it is redundant and is otherwise addressed in the ACNC Act. The Commissioner has power in the ACNC Act to investigate and monitor charities and report issues of non-compliance to the relevant government agencies which are able to take appropriate action (including impose fines or penalties, or seek to prosecute criminal offences). Also, the Commissioner has been granted broad powers in the ACNC Act to maintain and protect public trust and confidence – which ultimately includes deregistration in some circumstances.

The circumstances in which an entity can be deregistered include if the entity is not entitled to registration. An entity which is engaging in serious, unlawful activities is unlikely to be eligible for registration as a charity because the activities will be factored into the holistic assessment of whether the entity is established for a charitable purpose (which by its nature must be for the public benefit and cannot be an unlawful purpose).

6. **Governance standard 4 - responsible management of financial affairs**

On page 17, the second paragraph is as follows (emphasis added):

*The steps an entity could take include the general practices of the charity around the spending of funds (for example, who can write cheques or approve expenditure) as well as **who bears the risk** and what procedures should be followed if, say, fraud occurs.*

The meaning of "who bears the risk" and the purpose of including that reference is unclear.

The risk would normally be borne by the registered charity, which may well manage that risk by having insurance in place. If not the registered charity, the only alternative appears to be the responsible entities.

If there is any suggestion or implication that in some circumstances the responsible entities may be expected to bear the risk, this should be clarified. In our opinion, placing the burden of that risk on the responsible entities is inappropriate.

7. **Governance standard 5 - Suitability of responsible entities**

The Consultation Paper seeks feedback on whether there are concerns with allowing the ACNC to disqualify responsible entities and maintain a disqualified responsible entities register. While there are good policy reasons for the ACNC having these powers, in our opinion they affect the civil liberties of individuals and that in this case, the protection of those civil liberties is a strong countervailing argument against allowing the ACNC to disqualify responsible entities and maintain a disqualified responsible entities register. Further, the constitutional basis for the extension of the governance standards to this extent is not clear.

We **recommend** that the standards do not include the ability to disqualify responsible entities and maintain a disqualified responsible entities register.

8. **Governance standard 6 - duties of responsible entities**

We have several concerns in relation to this standard.

8.1 Perceived material conflict of interest

Firstly, we are concerned by the introduction of a duty to disclose a "perceived" material conflict of interest. This is subjective and is, in our opinion, likely to be problematic in practice. It goes beyond existing requirements and in doing so introduces a new duty that is not contained in the *Corporations Act 2001*, with therefore no body of common law to provide guidance regarding its practical meaning. It is not consistent with the proposal to introduce "minimum" standards.

We **recommend** that the references to perceived conflicts of interest be removed from the standards.

8.2 Putting the duty on the registered entity

Secondly, we are concerned by the imposition of the duty onto the registered charity rather than on the individuals. The consequences for a charity of failure to comply with the standards can be quite severe. However, in practice it will be difficult to distinguish the actions of a charity from the actions of its governing body.

We **recommend** that examples be given to illustrate what would constitute “reasonable steps”, such as that it has appropriate policies or requirements in its constitution. This may provide some comfort to charities that might otherwise fear being held accountable for the actions of individuals over whom they have no control.

8.3 Volunteers

In relation to volunteers, it is our view that it may be appropriate to apply the same standards, but with less severe consequences.

8.4 Wording of proposed regulation 45-30(3)

We **recommend** that Note 2 to proposed regulation 45-30(3) should be in the text of the regulation itself. We suggest the following wording for paragraph 45-30(3)(c):

“if the registered entity is a company and paragraph (a) cannot apply because there is only one director or all the directors have a similar conflict – to the members of the registered entity; or”

9. Conclusion

In summary, we recommend:

- 9.1 That any requirements in the “in Australia Bill” which overlap with the ACNC Act and standards be expressed to apply only to entities that are not registered with the ACNC.
- 9.2 That the guidance material in the consultation paper be included as part of an explanatory memorandum (or equivalent) to the standards.
- 9.3 The removal of the reference to “character as a not-for-profit entity” in standard 1.
- 9.4 That a note be included in standard 1 which states that “if a charity’s governing rules provide that it is established for public charitable purposes, this is sufficient to meet the requirement [of standard 1, Item 2(a)]”.
- 9.5 That standard 2 is expressed to apply only to members with voting rights.
- 9.6 That standard 2 include a note stating that a registered entity may have the same persons as members and directors.
- 9.7 That the application of standard 2 to corporations established by statute be reviewed and clarified.
- 9.8 That standard 2 include a note giving examples of the types of entities that do not have members, for example, trusts.

- 9.9 That standard 2 specify whether “member” includes “shareholder” in the case of a public company limited by shares, or a proprietary limited company.
- 9.10 The deletion of standard 3 on the basis that it is redundant.
- 9.11 That the ACNC not be granted the power to disqualify responsible entities or to maintain a disqualified responsible entities register.
- 9.12 That the references to perceived conflicts of interest be removed from the standards.
- 9.13 That standard 6 include protections for a registered entity where it has taken certain steps, such as when it has appropriate policies or requirements in its constitution.
- 9.14 That Note 2 to proposed regulation 45-30(3) should be in the text of the regulation itself. We suggest the following wording for paragraph 45-30(3)(c):

“if the registered entity is a company and paragraph (a) cannot apply because there is only one director or all the directors have a similar conflict – to the members of the registered entity; or”.

If you have any queries regarding this submission, please contact the Moores Legal Not-for-profit Team.

Again, we thank The Treasury for the opportunity to comment on these important proposed changes.

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