

Manager
Philanthropy and Exemptions Unit
Indirect, Philanthropy and Resource
Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

15 February 2012

Dear Sir or Madam

Submission – The Development Governance Standards Consultation Paper

We appreciate this opportunity to make a submission to advance the development of governance standards for the not-for-profit sector.

More than a decade after the first parliamentary inquiry into charities and the not-for-profit sector the federal government is making some advances towards reform. The centrepiece of the federal government's reform is the new Australian Charities and Not-for-Profit Commission. For the first time in Australia we have a dedicated body which has the responsibility and regulatory authority specifically for not-for-profit organisations. The new national regulator and the proposed governance standards may be improved further to achieve good governance practices for the sector.

Enclosed is our submission based on the specific questions raised in Consultation Paper, Development of Governance Standards, released in December 2012.

Should you require additional information on our views, please do not hesitate to contact Ms Kim D. Weinert, Faculty of Law Bond University via email kweinert@bond.edu.au and/or Assistant Professor Liz Spencer, Faculty of Law Bond University via email lspencer@bond.edu.au.

Yours faithfully

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Encl.

**Submissions to the Development of
Governance Standards Consultation Paper**

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Table of Contents

Introduction	2
Terminology and Glossary	3
Draft Governance Standard 1: Purpose and Not-for-Profit Nature of a Registered Entity	5
Draft Governance Standard 2: Purpose and Not-for-Profit Nature of a Registered Entity	10
Draft Governance Standard 3: Compliance with Australian Laws	13
Draft Standard 4: Responsible Management of Financial Affairs	14
Draft Governance Standard 5: Suitability of Responsible Entities	16
Draft Governance Standard 6: Duties of Responsible Entities	19
Concluding Remarks.....	26

Introduction

The federal government's *Development of Governance Standards - Consultation Paper* ('the Consultation Paper') seeks feedback on the proposed governance standards for charities and other forms of not-for-profit organisations.

This submission will:

- (a) analyse each proposed governance standard outlined in the Consultation Paper;
- (b) respond to the questions outlined in the Consultation Paper; and
- (c) outline how governance, accountability and transparency for Australia's not-for-profit sector can be improved by developing the *Australian Charities and Not-for-Profits Commission Act 2012* (Cth) and its forthcoming accompanying Regulations.

The not-for-profit sector and its unique institutions have, in recent times, faced rising public expectations to have an improved model of governance. This insistence on not-for-profit entities to be transparent is derived from the perception that a not-for-profit's appearance and function run parallel to those of a for-profit entity. This appearance of not-for-profit organisations operating in a manner akin to for-profits has led to numerous misunderstandings surrounding not-for-profit organisations.

This submission will further evaluate:

1. whether the proposed governance standards, which are (largely based on corporate rationale for company directors,) are appropriate for not-for-profit organisations; and
2. whether the proposed standards improve the governance and transparency of not-for-profit organisations.

This submission demonstrates how these proposed governance standards could be improved to facilitate: (i) a not-for-profit organisation achieving its altruistic objects; and (ii) effective management of risk and trading activities by the controlling committee.

Terminology and Glossary

'The law must be clear!' This is one of the four fundamental principles of the rule of law.¹ Unfortunately this globally-acknowledged precept could not be said about the *Australian and Not-for-Profits Commission Act 2012* (Cth)² or its proposed governance standards. The root of confusion lies in the terminology used by the *ACNC Act*, which is conceptually problematic. For example, how will the Commissioner enforce provisions of the *ACNC Act* and governance standards when an entity is not recognised by the law, such as an unincorporated association? Likewise, how can the Commissioner hold a charity as an entity liable when its legal form is expressed by a trust deed, which does not have a legal personality?

The *ACNC Act* treats a company and a charitable trust as the same,³ - when there are fundamental differences between the two. This over-reaching term ignores certain legal principles and test, and the body of jurisprudence, which are crucial to differentiating one organisational from the other. Labelling all types of not-for-profit organisations as entities compromises the sector's diversity, which we see as critical to the success of the sector, and correspondingly should be supported rather than undermined by government regulation.

As these terms now have statutory force and the authors of this submission accepts the reality that they not going to be changed. However, to avoid further confusion the terms and the concepts used here are terms already utilised within the not-for-profit sector. Below is list of terms and its meanings used throughout this submission:

ACNC Act – *Australian Charities and Not-for-Profits Commission Act 2012* (Cth).

ATO – The Australian Taxation Office.

Controlling Committee – This expression includes a group of individuals who are in a position of power and control over an organisation's operation. Commonly referred to

¹ Tom Bingham, *The Rule of Law* (Penguin, 2011) 37.

² Hereafter referred to as the '*ACNC Act*'.

³ *ACNC Act* s 205-30.

as a: management committee; the executive committee; board of directors; and trustees.

Entity – References to an entity in this submission means all organisational forms of not-for-profit organisations under the *ACNC Act*.

The Commissioner – Means the Commissioner of the Australian Charities and Not-for-Profit Commission.

The Sector – Numerous terms have been used to ascribe the not-for-profit sector, none of which has proven to be entirely adequate.⁴ For the purpose of the submission the term ‘the sector’ refers to the generic term ‘not-for-profit sector’ being; the space outside of the market, the state and the house-hold sectors.

⁴ For example, the term ‘charitable sector’ emphasises and describes only one type of non-profit organisational form and it overlooks all the other different forms of the wider sector. Lester Salmon and Helmut Anheier, ‘In Search of the Nonprofit Sector I: The Question of Definitions (Working Paper No 2, The Johns Hopkins Comparative Nonprofit Sector Project, The Johns Hopkins Institute for Policy Studies, June 1992) 4.

Draft Governance Standard 1: Purpose and Not-for-Profit Nature of a Registered Entity

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 purpose and its character as a not-for-profit entity.

Does the draft standard one establish the appropriate principles?

The overarching aim of the *ACNC Act* is to strengthen the sector's accountability and transparency⁵ and this draft standard makes advances towards that aim. Draft standard one provides an entity with a sense of awareness about its altruistic purpose and, also, how well an entity is being managed in accordance to its rules. However, sub provisions (a) and (c) requires an entity to demonstrate its not-for-profit nature. It is suggested that it would be preferable to require an entity to explain its organisational form.

Draft standard one's requirement for an entity to prove its not-for-profit nature is more relevant for registration purposes with the ACNC and the ATO, and does not necessarily reflect the principles of governance. While the authors acknowledge that this standard may affect the practice of an entity's governance, it does not necessarily align with principles of governance. Governance is fundamentally concerned about how organisations are managed and how a controlling committee are accountable for their decisions. Therefore, this draft standard should be redrafted to reflect the underlying principles of governance.

Is the wording of draft governance standard one appropriate?

⁵ Australian Charities and Not-for-Profit Commission Bill 2012, Explanatory Material Summary of Regulation Impact Statement, 4.

The main concern regarding the construction of draft standard one is the usage of the terms ‘not-for-profit entity’ and ‘not-for-profit’. Surprisingly, the *ACNC Act* does not define these terms. While this may seem to many as unnecessary for the reasons that everybody knows, or at least, has an understanding of these terms, nevertheless, it is prudent that such an important terms be defined.

It has become an increasingly challenging task to clearly differentiate between a not-for-profit organisation, a public agency, and a for-profit organisation, not to mention the growing field of hybrid entities. This challenge illuminates the complexity and behaviour of not-for-profit organisations, which has blurred the sector’s boundaries.⁶ Why the *ACNC Act* does not provide the meaning of a ‘not-for-profit entity’ is a mystery, but the result is that *ACNC Bill* and its Explanatory Material is used as the guiding instrument on this point.

The *ACNC Bill* does not expressly provide a meaning of a not-for-profit entity but it makes reference to the *Income Tax Assessment Act 1997 (Cth)*.⁷ The glitch here is that the *Income Tax Assessment Act 1997 (Cth)* does not provide a definition of a not-for-profit entity and it is the preceding *Income Tax Assessment Act 1986 (Cth)* which defines a not-for-profit entity. Section 3 of the *Income Tax Assessment Act 1986 (Cth)* defines a not-for-profit entity to be ‘a company that does not carry on for the purpose of profit, or gain to its individual members and the terms of the company’s constitution prohibits any distribution of money or property to its members or a friendly society dispensary.’ This definition may be sound for taxation purposes but it fails to encapsulate all of the structural operational characteristics of a not-for-profit organisation.

The *ACNC Bill* and *ACNC Act* could simplify the meaning of a not-for-profit organisation by adopting the structural-operational definition, which is conceptually clearer than the definition contained in the Tax legislation.⁸ Directly adopting the

⁶ Kim Weinert, *Reforming Not-for-Profit Organisations in Australia – A Work in Progress* (LLM (Research) Thesis, Bond University, 2013) 14.

⁷ *ACNC Bill* ch 8 pt 8-2 dv 900 cl 900-5.

⁸ The hallmark of a not-for-profit organisation can display all of the five structural-operation characteristics which are: (i) organized; (ii) private; (iii) self-governing; (iv) non distribution of

structural-operational definition would remove the confusing and unnecessary reference to two Income Tax Assessment Acts and, further, be consistent with the Australian Bureau of Statistics usage of the structural-operational definition.

There are further concerns regarding the terms used in draft standard one. First, is the use of the term ‘governing rules’ and its very broad meaning.⁹ The suggestion is to narrow this term and to use the term ‘governing document’.

It is recommended that the term ‘governing rules’ be replaced with ‘governing document’.¹⁰ This recommendation may seem to be an insignificant detail and the reasoning behind this is two-fold. The first point is that term ‘governing document’ is commonly used within the sector, and there is very little benefit in the renaming a commonly used term. The second point is that adopting the term ‘governing document’ it is more appropriate to the importance of this stand-alone document, - which is otherwise lost in the haze of generalities under such a wide term as ‘governing rules’.

An entity’s governing document provides more than by-laws as it serves as a contract between members and the entity,¹¹ as well as, the framework on how an entity is to manage its affairs. It also outlines a member’s rights. The Consultation Paper states that an entity’s governing document will not be a prescribed document.¹² This is reflective of the principles-based standard explained in Part 1 of the Consultation Document, which provides an entity with the freedom to decide (in a democratic manner) the shape of the governing document. While this feature may be portrayed

profit; and (v) non-compulsory or voluntary. Helmut Anheier, *Nonprofit Organisations – Theory, Management Policy* (Routledge, 2005) 47; United Nations Handbook of National Accounting, *Handbook on Non-Profit Institutions in the System of National Accounts* (2003) 18.

⁹ Governing rules appears to include any document that should be observed by an entity, which includes legislation and an entity’s constitution. See the Consultation Paper, 11.

¹⁰ A governing document refers to an entity’s constitution, memorandum of association, trust deed and cooperative rules.

¹¹ *Verduci v Catanzarita* (1981) 53 FLR 156; *Islamic Council of South Australia Inc v Australian Federation of Islamic Councils Inc* [2009] NSWSC 211; *Rose v Boxing NSW Inc* [2007] NSWSC 20. This rule is applicable to unincorporated and incorporated entities and companies limited by guarantee.

¹² See the Consultation Paper, 12.

as an innovative step, not-for-profit organisations have always had this freedom.¹³ Through the states' incorporated association legislation and the *Corporations Act 2001* (Cth) offer prescribed documents through its model rules and replaceable rules, these provisions do not significantly impact upon this freedom. It is important that a governing document be drafted to be meaningful to ensure that there is no misunderstanding about the source of an entity's rules.

For a governing document to be useful it must provide a framework for an entity to pursue its objects and to enjoy legal protection. Necessary to this document are terms that address the following matters:

- i. the non-distribution of profit principle;
- ii. an entity's object or purpose;¹⁴
- iii. management structure (i.e. controlling committee and sub-committees);
- iv. administrative arrangements (i.e. meetings);
- v. members' rights;
- vi. dispute management; and
- vii. procedures for winding up.

This recommendation does not suggest that an entity's governing document contains only the matters listed above. With the guidance and education provided by the ACNC an entity will be capable of drafting (for itself) a useful governing document, which contains unambiguous language about how that entity is to be structured and managed.

Narrowing the meaning of governing rules would omit references to legislation and church law. The exclusion of these words would not be fatal. It is recommended that the statute be amended so that its accompanying regulations include a provision, which places a clear and positive obligation on the controlling committee to comply

¹³ The characteristic of self-governing in the structural-operation definition refers to an entity having the ability to change its by-laws, internal structure and alter their mission. United Nations Handbook of National Accounting, *Handbook on Non-Profit Institutions in the System of Nations Accounts* (2003) 19-20.

¹⁴ Charities must also illustrate how the public benefit test is satisfied. However, the *ACNC Act* excludes the core legal tests for charities such as, the public benefit test and the doctrine *cy-prés*. Furthermore, the *ACNC Act* does not deal with Royal Charter Charities.

with the laws of Australia (including statute, the common law, the rules of equity and charity law). This supplementary provision would preserve the efficacy of laws, which is otherwise lost under such a broad term.

The reference to church (canon) law is unclear since religious organisations are exempt from satisfying certain provisions under the *ACNC Act*¹⁵ and the Commissioner has no enforcement powers over a basic religious charity.¹⁶ Under these circumstances it would not be necessary for religious entities to demonstrate compliance to church and/or canon law.

Sub-paragraph (b) of draft standard one largely reflects the content, which an entity must report upon for the purposes of completing an Annual Information Statement.¹⁷ From a drafting perspective this sub-paragraph should be cross-referenced to the Annual Information Statement to avoid duplication in the requirements.

Overall standard draft one compels an entity to revise its overall performance to discover if an entity is correctly engaging in activities, achieving its object and if the entity is reaching its targeted beneficiaries. This requirement and sub-paragraph (b) will ultimately show an entity's productivity and efficiency, which will go some distance to restore and underpin the public's trust and confidence in the sector.

¹⁵ A basic religious charities are not required satisfy the financial reporting requirements under the *ACNC Act* ch 3 pt 3-2 dv 60 s 60-60 (i). However, subsection (ii) of 60-60 of the *ACNC Act* states if a basic religious entity does furnish the Commission with a financial report then the division 60 applies. Confusing? Yes.

¹⁶ *ACNC Act* ch 4 pt 4-5 dv 100 subdv 100-B s 100-5

¹⁷ Australian Charities and Not-for-Profits Commission, *Reporting* <http://www.acnc.gov.au/ACNC/Manage/Ongoing_Obs/Reporting/ACNC/Edu/Reporting.aspx>.

Draft Governance Standard 2: Purpose and Not-for-Profit Nature of a Registered Entity

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.

Does draft standard two establish the appropriate principles?

Draft standard two is a welcomed feature, but why should it only apply to entities with members? The requirement for entities to be transparent and accountable should apply equally to most other forms of entities. Looking more closely at this draft standard and the *ACNC Act* there seems to be a constraint on the practise of governance.

Under the *ACNC Act* there are provisions dealing with record keeping and recording,¹⁸ and governance standards will be subjectively applied to entities. The Commissioner has the discretion to decide which governance standards will apply to specified kinds of entities.¹⁹ This approach appears to be incongruous with the fundamental aim to build confidence and trust within the sector through governance mechanisms.

While it is acknowledged that this selective approach supports the Commissioner's proportionality to regulation it raises numerous concerns. One concern is that it will be difficult for entities to know precisely what is required of them.²⁰ Another concern is that too much discretion may require the Commissioner to make decisions in a more arbitrary way. Thirdly, the subjective picking-and-choosing as to which

¹⁸ For example, only medium and large entities are to provide annual final reports. *ACNC Act* s 60-1.

¹⁹ *ACNC Act* s 45-10(3).

²⁰ Although an entity will eventually know what rules applies to them but until such time the ACNC makes that decision an entity is in limbo. Contributing to this uncertainty is that there are no provisions requiring the Commission to make these decisions or directions within a certain time period. Further, direction as to how the ACNC will make these decisions is needed.

provisions of the *ACNC Act* and Regulations apply may allow for poor behaviour to go undetected. This approach gives an impression, which the public will have difficulty in comprehending, that fundamental principles of governance are not required to be followed. To avoid this negative impression it is recommended that all the provisions and governance standards apply to all entities and that entities are permitted to apply to the ACNC for exemption from certain provisions. This would force entities to carefully consider and comprehensively explain to the ACNC why they should be exempt. This ‘comply or explain’ model is used in other jurisdictions and should be closely considered for not-for-profit entities.

Is the wording of draft governance standard two appropriate?

Further to the above concerns the wording of draft standard two should be expanded to be applicable to all entities. Draft standard two should be redrafted and an additional standard should be included. The redrafted standard should be as follows:

- 2) The controlling committee of an entity are answerable and accountable to its members and beneficiaries.

- 3) Without limiting the above provision the controlling committee of an entity must take reasonable steps to provide adequate disclosure of information to its members, beneficiaries and donors about the entity’s governance, administration and management.

The additional standard below address the quality of the information an entity must disclose.

Continuous Disclosure

- 1) Continuous disclosure of information under [insert appropriate provision number] is required.
- 2) Information that is not required to be disclosed:
 - (a) information that is a trade secret;
 - (b) information relating to an incomplete proposal or a matter in the course of negotiation;
 - (c) information that would be considered confidential.

The rationale behind this additional provision will place the obligation upon the controlling committee, rather than the members to carry out the responsibility of governance. Moreover, the information, which a controlling committee provides, must be adequate; -otherwise there will be no or very little value to this disclosure provision.²¹ To achieve a model of good governance it is imperative that disclosure of information be continuous and timely.

²¹ Where misconduct is occurring within not-for-profit organisations it has been found that rules and codes of conduct will be interpreted for self-interest and preservation. See Kim Weinert, 'Is There a Perfect Environment for a Villain and Villainess to Survive?' in Rachel Franks and Susan E. Meindi (eds), *The Real and Reflected: Heroes and Villains in Existent and Imagined Worlds* (Inter-Disciplinary Press, 2012).

Draft Governance Standard 3: Compliance with Australian Laws

A registered entity must not engage in conduct, or omit to engage in conduct, that 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.

Does draft standard three establish the appropriate principles?

The Consultation Paper states that draft governance standard three is *only* applicable to a registered charity.²² The application of this standard should be reconsidered to apply to all forms of entities. This blanket application is on the basis that all forms of not-for-profit organisations are capable of committing an indictable offence/s and, also, they too are subject to the civil penalties under the *ACNC Act*.

Requiring all forms of entities to follow this standard will keep entities behaving on the right side of the law. Subsequently, making all forms of entities subject to draft standard three will confer greater confidence and trust in the sector.

Is the wording of draft governance standard three appropriate?

The wording of draft standard three is awkward. The provision as it stands could be clearer as there are many pieces of legislation which entities are subject to. Therefore it is better for sub-section (b) to clearly make the connection to the *ACNC Act*. See below.

Sub-paragraph (b) should be amended to include the following:

- (b) by way of a civil penalty of 60 penalty units or more imposed under the *ACNC Act*.

²² See the Consultation Paper, 15.

Draft Standard 4: Responsible Management of Financial Affairs

2) A registered entity must take reasonable steps to manage its financial affairs in a responsible manner.

Does Draft Standard Four establish the appropriate principles?

Draft standard four, in general, is a welcomed feature but it is limiting in supporting the broader principles of governance. The management of an entity (whether a not-for-profit, or a for-profit) is not always primarily focused on how it manages its financial affairs, - although this is an important aspect of management it is not a definitive function of management, particularly in the not-for-profit sector.

Is the wording of draft governance standard four appropriate?

Strengthening draft standard four can be achieved by removing the term 'financial affairs' and replace it with the word 'affairs'. The broad term of 'affairs' could include the following (without limitation):

- the promotion of an entity's object;
- the creation, winding-up, dissolution or merger of entities;
- matters arising, under or in relation to the terms of the entity's governing document;
- the internal management and proceedings of an entity within the terms of the governing document;
- any act or thing done, or in relation to the promotion of an entity's object and/or administration (including proceedings) of an entity's activities or property;
- the power of persons (including members) to exercise the right to dispose of an entity's property;
- financial matters;
- matters concerned with investment schemes; and
- liabilities of the entity;

Some aspects of the above list can be found in sections 53, 53AA, 53AC and 53AD of the *Corporations Act 2001* (Cth). However, keeping it broad this will emphasise that good management practises involve more than just managing finances.

Draft Governance Standard 5: Suitability of Responsible Entities

A registered entity must:

- a) take reasonable steps to ensure that each of its responsible entities meet the conditions mentioned in subsection (3) [see below]; 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.

Subsection 3

Subject to subsection (5), the conditions for each responsible entity are that it is not:

- a) disqualified from managing a corporation, within the meaning of the *Corporations Act 2001*; or
- b) disqualified by the Commissioner, at any time during the preceding 12 months, from being a responsible entity of a registered entity under subsection (4).

Subsection 4

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

- a) the entity has been previously suspended or removed as a responsible entity of any registered entity, under Division 100 of this Act; and
- b) the entity has been given notice of its disqualification by the Commission; and
- c) the Commissioner reasonably believes that the disqualification is justified having regard to the objects of the Act.

Subsection 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.

Subsection 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.

Subdivision 45-D Register

The Commission must maintain a register, to be known as the Disqualified Responsible Entities Register, in which the Commission must include the following information:

- a) the name of the entity disqualified by the Commissioner from being a responsible entity of a registered entity, under subsection 45.25(4);
- b) the date that the entity was disqualified by the Commission;
- c) whether the disqualification remains subject to review, under Part 7-2 of the Act.

The Register must be maintained by electronic means.

The Register must be made available for public inspections, or a website maintained by the Commission.

Does draft standard five establish the appropriate principles?

The convoluted language used in the *ACNC Act* makes this draft standard unnecessarily complicated. The thrust of draft standard five means that individuals can be disqualified (or suspended) from holding a position on the controlling committee where:

- the Commissioner finds an a person has not complied with the *ACNC Act*; and
- the Commissioner is satisfied that a person meets the disqualification provisions under the *Corporations Act 2001 (Cth)*.²³

The latter sub provisions of this draft standard largely relate to the Commission's regulatory and administrative function rather than the principles of governance. Although it is arguable that keeping a registry of disqualified entities satisfies the Commissioner's function to improve transparency of the sector under the *ACNC Act*,²⁴ the nature of this draft standard is principally concerned with administration and enforcement.

It would be prudent to consider how this draft standard could be harmonised with existing rules and laws for disqualification under the respective state incorporated associations' legislation, as well as the *Corporations Act 2001 (Cth)*.

²³ *Corporations Act 2012 (Cth)* pt 2D.6.

²⁴ *ACNC Act* s 110-10(2).

Is the wording of draft governance standard five appropriate?

Further to comments above it is suggested that the Commissioner's function to keep and maintain the Disqualification Registry be referenced to the provisions dealing with the Commissioner's regulatory and administration functions.

Are there concerns with allowing the ACNC to disqualify responsible entities and maintain a disqualified responsible entities register?

There are no obvious concerns about the Commissioner's power to disqualify or suspend entities. The use of this discretionary power should only occur when there are reasons to believe that an entity's conduct is unlawful and likely to cause harm to the sector (in accordance with the main Objects of the *ACNC Act* ²⁵). The Commissioner in exercising their discretion must be done in good faith and, moreover, an entity has the benefit of substantive and procedural fairness. It is also anticipated that an aggrieved entity can appeal against the Commissioner's decision of disqualification and suspension.

Establishing a disqualification registry it is necessary that reasons for the Commissioner's decisions for disqualification or suspension be available and easily accessible to the public. This will establish a body of decisions and advance the general public trust and confidence not only in the sector, but also in the ACNC.

²⁵ *ACNC Act* s 15-5.

Draft Governance Standard 6: Duties of Responsible Entities

Object

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, donor, employees, volunteers and benefit recipients of 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.

(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 best interests of the registered entity, to further the purpose 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;
- (f) not to allow the registered entity to operate while insolvent.

(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.

(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) *Corporations Act 2001* (Cth).

Does draft standard six establish the appropriate principles?

The analytic substance of draft standard six appears to be to curb the arbitrary power of a controlling committee and to prescribe how an individual must act for the entity's interest rather than in his or her own interest. However, the Object of this standard is perplexing, and potentially detracts from efficacy intended for this standard.

Much confusion about the Object arises from the term 'fiduciary relationship'. Subsection one states that a responsible entities of a registered entity (being a company director, a trustee)²⁶ are obliged to conduct themselves in a manner that is consistent with a fiduciary relationship, but *only if* [my emphasis] the relationship is a fiduciary one.²⁷ A responsible entity of a registered entity falls within recognised and well-established fiduciary categories and, furthermore, this subsection does not recast or advance the concept and the circumstances were a fiduciary relationship might exist. So, it is not clear why the term 'fiduciary relationship' has been added here. It appears to serve only to undermine the intended aim of this standard.

While an Object to a provision does not carry great statutory force the issue arises: when a controlling committee in addressing this Object will follow strict fiduciary rules, a court may find that in the circumstances, a fiduciary relationship is

²⁶ Includes, a trustee in bankruptcy, a receiver, an administrator and a liquidator. *ACNC Act* s 205-30.

²⁷ See Object (1) (a)(i)-(ii) Standard Six of the Consultation Paper, 22.

improbable.²⁸ Conversely, a court may find a fiduciary relationship but a committee has not properly adhered to fiduciary standards. This Object may lead to unintended outcomes and/or conflict with long-standing precedent.

Another obscurity in this Object is subsection (1)(a)(ii) which requires a minimum standard be applied to a fiduciary relationship. There are no minimum standards to a fiduciary relationship and a finding of fiduciary relationship imposes *strict* equitable obligations. Therefore the word ‘minimum’ should be omitted from subsection (1)(a)(ii), - only if this sub provision is to remain and more consideration should be given as to how this Object (and the *ACNC Act*) is to operate against established case law.

Is the wording of draft governance standard six and the draft protections appropriate?

This draft standard reflects many of the legal duties for corporations. We question, however, whether it is appropriate to apply corporate laws to not-for-profit organisations, - bearing in mind the different functions and organisational features between the two. Caution must be exercised when attempting to treat not-for-profit organisations as quasi-corporations. It is of great importance that the sector’s independence and diversity not be compromised by treating and viewing its organisations (out of convenience) as a corporation. Preserving a not-for-profit organisation’s uniqueness while, at the same time, establishing suitable legal duties to regulate their operation is both necessary and achievable.

Accomplishing this task can be done by building upon draft standard six and using provisions from other jurisdictions²⁹ as a blueprint for the following recommendation:

²⁸ The courts are very reluctant to impose a higher standard of conduct prescribed under equity even where the parties’ relationship falls within a established fiduciary category. The courts have shown that they will not draw upon strict equity principles and will prefer to find a relationship in contract and/or torts. See *Hospital Products Ltd v United States Surgical* (1984) 156 CLR 41.

²⁹ Being the jurisdictions of the United Kingdom and New Zealand.

General Duties

- (1) An individual of a controlling committee must –
- (a) act in a manner which is consistent with the entity’s purpose;
 - (b) act in accordance with the entity’s constitution;
 - (c) only exercise powers for the purpose for which they are conferred; and
 - (d) comply with any direction, requirement, notice or duty imposed by the virtue of the *ACNC Act*.

Duty to Promote the Purpose of the Entity

- (1) An individual of a controlling committee will act in a manner that is proper and in good faith that will most likely promote the entity’s purpose for the benefit of its members and for the entity as a whole, and in doing so will have regard to –
- (a) any likely consequences of any decision;
 - (b) the interests of the entity;
 - (c) the interests of the entity’s members;
 - (d) the interests of a beneficiary;
 - (e) the interests of the entity’s employees;
 - (f) the interests of suppliers, customers and others;
 - (g) the impact of the entity’s operation on the community; and
 - (h) maintain high standards of conduct.

Duty to Exercise Independent Judgment³⁰

- (1) An individual of a controlling committee and members must exercise independent judgment.
- (2) This duty will not be in contrary to any provisions authorised under the entity’s governing document.

³⁰ The inclusion of this duty may first appear strange. There have been many reported incidences where dominant personalities influence the way votes are casted and how some matters are decided. The sentiment behind this statement is not to offend nor is it a sweeping generalization of how entities functions. The inclusion of this duty is to promote discussions about how the entity can best to manage and remedy issues affecting the entity. Debra Morris, *Disputes in the Charitable Sector* (February, 2003) Charity Law Unit, University of Liverpool <<http://www.liv.ac.uk/law/clu/projectreports.thm>>.

Duty to Exercise Reasonable Care, Skill and Diligence

- (1) An individual of a controlling committee must exercise reasonable care, skill and diligence in managing and administering the affairs of the entity.
- (2) This duty means the care, skill and diligence would be exercised by a reasonable diligent person with –
 - (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the function in relation to the entity's purpose; and
 - (b) the general knowledge, skill and experience that the individual has; and
 - (c) if, an individual has or holds themselves out as having any special knowledge or experience then it is reasonable to expect a person to exercise such skill and experience in those circumstances.

Duty to Avoid Conflicts of Interest

- (1) An individual of a controlling committee and/or a member must avoid a situation in which he or she has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the entity.
- (2) This duty applies to the exploitation of any property, information or opportunity, and it is immaterial whether the entity could take advantage of the property, information or opportunity.
- (3) This duty is not infringed where –
 - (a) the situation cannot be reasonably regarded as likely to be a conflict of interest; or
 - (b) the matter is authorised by the controlling committee.
- (4) Authorisation by the controlling committee is effective only when –
 - (a) the requirement as to the quorum is met at the meeting which the matter is considered, without counting the individual in question or any other interested individual; and
 - (b) the matter was agreed to without the concerned individual's vote or would have been agreed to if their votes had not been counted.

Duty to Declare Conflicts of Interest

- (1) If an individual of a controlling committee and/or a member is in anyway, directly or indirectly, interested in a proposed transaction or arrangement with the entity, that individual must declare the nature and extent of that interest to the controlling committee in accordance with this section.
- (2) The individual's declaration must be made –
 - (a) before the entity enters into the transaction or agreement; or
 - (b) within a reasonable time in which the individual becomes aware or which they ought to have been reasonably aware of the conflict;
 - (c) at a meeting; or
 - (d) by written notice to the effect that –
 - (i) the individual has an interest (as member, officer, employee or otherwise) is a body corporate or firm and is to be regarded as interest in any transaction or agreement that may be made with the entity; or
 - (ii) is connected with a person (other than a body corporate or firm) and is to be regarded as an interest in any transaction or arrangement that may be made with the entity.

The above recommended provisions serves as a direct way of regulating not-for-profit organisations to prevent undesirable conduct and to promote desirable conduct through power-conferring rules, -which places an onus of regulation on individuals themselves. Improving upon draft standard six these recommended duties are clear, use unambiguous language and, moreover, provides procedural guidance, which upholds the fundamental principles of governance, accountability and transparency.

The protection provisions outlined in this draft standard is welcomed as they provide a framework for a controlling committee to make decisions, pursue its objectives and be afforded legal protection. Further consideration is to be given as to the degree of liability (whether criminal or civil) in the event an individual of a controlling committee has breached a duty.

The argument against imposing criminal liability is that such penalties could discourage people becoming involved in not-for-profit entities. However, there is a plausible and convincing argument for criminal provisions to apply in this draft

standard to deter opportunistic management for self-gain, - this issue needs further consideration.

Are there additional protections which should only provided to volunteer responsible entities? If so, what would these protections be?

Consideration should also be given as to whether a controlling committee are protected when they delegate their power to others. Many governing documents create sub-committees where the controlling committee, theoretically, may delegate certain tasks and powers to others. Clarity is needed on this issue as the associations' legislation and this standard does not specify whether or not a controlling committee is ultimately responsible for the actions of the delegate. In the absence of such a provision the rules of agency would likely apply and, in the case of companies limited by guarantee section 189 of the *Corporations Act 2001* (Cth) would apply. Therefore, it is recommended that this draft standard include a delegation sub-provision.

Lastly, the states' civil liability statute affords volunteer protection from liability in particular circumstances and it is recommended that the federal government consider similar provisions covering volunteers undertaking community work.

Concluding Remarks

The modernisation of the not-for-profit sector requires wide reforms to improve its legal and regulatory frameworks. While the *ACNC Act* goes some way, further refinement is needed to make the law clear and accessible to allow individuals (particularly volunteers) to understand how to regulate their conduct, to foresee when it is appropriate to seek advice and, moreover, to be aware of the consequences when their conduct would be considered as unreasonable. It is particularly important to establish suitable rules for the sector that will direct behaviour towards achieving good governance practises. Considering that the *ACNC Act* does not require a Minister to institute a review of these laws. Therefore, ‘getting it right’ the first time is crucial, while further development is needed in certain areas.