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15 February 2013

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

Email: NFPReform@treasury.gov.au

Dear Sir,

Consultation Paper: Australian Charities and Not-for-profits Commission – Development of governance standards

The Australian Institute of Company Directors (Company Directors) welcomes the opportunity to offer comment to Treasury on the Consultation Paper: *Australian Charities and Not-for-profits Commission – Development of governance standards.* Company Directors is the second largest member-based director association worldwide, with over 32,000 individual members from a wide range of corporations: publicly-listed companies, private companies, not for profit organisations (NFPs), and government and semi-government bodies. As the principal professional body representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current director issues in policy debates.

The NFP sector is, and has, been a particular area of focus for Company Directors. Our activities include tailored educational services, events, published materials, research and facilitation of dialogue among members and others on NFP issues. Additionally, we have participated in NFP policy reform discussions and lodged various submissions, which we have developed in consultation with our membership, including with our Policy Committees and NFP Steering Committee.

We acknowledge that these standards have already been the subject of consultation within the industry and we believe that they have been significantly improved from an earlier draft.

Overall we are generally supportive of the draft governance standards, however we believe they could be improved with some further amendments.

In summary, specifically we believe:

- the term "responsible entity" should be changed as it is confusing and inconsistent with drafting language in other jurisdictions(we note this would require an amendment to the Australian Charities and Not-for-profits Commission Act 2012 (the ACNC Act);

- further clarification is required in governance standard 1 as to how a registered entity is to make information available to the public about its purposes;
- the wording of governance standard 2 is problematic and needs to be amended;
- governance standard 3 regarding "Compliance with Australian laws" is not required;
- Governance standard 4 should be re-drafted and make reference to 'reasonable' rather than 'responsible' management of financial affairs;
- To the extent governance standard 5 is required, obtaining declarations from "responsible entities" should be sufficient to meet the standard;
- further clarification is required on governance standard 6 Protection 2 (1) (b) as to what constitutes a material conflict of interest; and
- governance standard 6 Protection 2 (1) should be re-drafted to make express reference to the Business Judgment Rule.

These amendments are discussed in detail below.

Use of the term "responsible entity"

As has been raised by Company Directors and other stakeholders previously, the term "responsible entity" is confusing and inconsistent with drafting language in other jurisdictions.

Importantly the term "responsible entity" has an entirely different definition in the *Corporations Act* (relating to the trustee of a registered managed investment scheme), which heightens this confusion.

We believe that the terms "directors and officers" is more appropriate and widely understood. We appreciate that "responsible entity" has been used throughout the Australian Charities and Not-for-profits Commission Act and as a result this Act would need to be amended.

Draft Governance Standard 1— Purposes and not-for-profit nature of a registered entity

Further clarification is required on clause 2 (b) of this standard. Specifically, how a registered entity is to make information available to the public about its purposes. The current wording for this standard is too prescriptive and does not adequately capture the diversity within the sector.

Given the significant diversity in size of charities within the sector, the process for how they make this information available will differ.

For example, for a small charity with few stakeholders and scarce of resources, it should be sufficient for the public to rely on information made available through the ACNC. A large charity, with a diverse group of stakeholders and operational capability, may choose to make this information available on their own website and through other communication channels e.g. annual reports.

Draft Governance Standard 2—Accountability to members

We believe the wording of this standard, ie "A registered entity, that has members must **take reasonable steps** to ensure that...", is problematic.

In particular, the obligation to "take reasonable steps" is ambiguous and open to interpretation. As a result, it has the potential to place increased pressure on the ACNC to make subjective determinations about an entity's adherence to this standard.

We believe the standard should be redrafted as follows to offer further clarity to entities on what is required to meet this standard...

"A registered entity, that has members must have **appropriate procedures and frameworks in place** so that...".

Additionally it should be expressly stated how governance standard 2 interacts with the proposed Reporting Framework and that the information the entity needs to provide to the public is relative and appropriate for their Reporting Tier.

Much of the confusion around the standard arises from the examples provided in the two notes to the standard, both of which are most appropriate for large entities as opposed to the large majority of small and medium charities in the sector. As a result, it is possible that upon reading this standard, every registered entity will believe they need to prepare full financial reports as well as develop mechanisms such as annual general meetings.

Further guidance needs to be provided to ensure that the standards are easy to read and adapted appropriately by organisations of different size. This may involve clarifying that a large entity is required to prepare financial reports and hold annual general meetings, whereas a smaller entity may comply with the standard by, for example, sending a regular newsletter to members which provides an update on the entity's activities and sets out the contact details of a person who has been nominated to answer members' questions.

Draft Governance Standard 3— Compliance with Australian laws

We contend that such a standard is not required. All organisations and their directors and officers are required to comply with Australian laws. A recent report published by Company Directors indicated that there were over 600 pieces of such legislation that directors must comply with.

If this standard has been included to simply cover the de-registration powers of the ACNC over non-Federal governed entities, then we request that a different method is used to achieve this outcome.

Draft Governance Standard 4— Management of financial affairs

We believe the standard should be re-drafted and make reference to **'reasonable'** management of financial affairs as opposed to 'responsible' management of financial affairs. The term 'reasonable' already has accepted meaning and interpretation.

We refer you to the submission by Alice Macdougall, Herbert Smith Freehills, on the governance standards for the suggested redraft of this standard.

Draft Governance Standard 5— Suitability of responsible entities

While the *Corporations Act* and associated incorporations legislation contain eligibility criteria for directors and officers, the suggestion in governance standard 5 that taking "reasonable steps" to ascertain eligibility may require registered entities to search registers would be unique to this legislation. This additional step required of registered charities, that is not generally required of other organisational forms in Australia, has the potential to add to their compliance burden.

In particular, it seems cumbersome and time consuming for registered entities to have to perform regular checks and searches to ascertain the ongoing eligibility of their "responsible entities". The governance standard provides no guidance as to how often these checks need to be completed. Under the current drafting it could be very possible that a registered entity feels as though they need to complete searches each day to meet this standard.

We suggest that while it may be appropriate to retain the general requirement that charities do not engage disqualified persons to manage the charity, the standard should be amended so that obtaining a declaration is sufficient to satisfy this requirement.

Draft Governance Standard 6— Duties of responsible entities

We recognise that this standard has largely been based on sections 180 -184 of the Corporations Act, a key difference being that the responsibility for compliance is largely placed on the registered entity.

We understand that this has been drafted in this way due to the powers of the Commissioner. Another reason may be to reduce the legal burden on "responsible entities" or directors, who for the large part are performing their role voluntarily. Any steps taken by the ACNC and Government to not discourage directors from contributing to the charitable sector are positive.

Conflicts of interest

Protection 2 (1) (b) should be clarified as to what constitutes a material conflict of interest for a "responsible entity" of a charity. This has the potential to cause confusion because many organisations have directors who have a personal interest in the organisation they serve. For example, a human services organisation may have people on their board that either suffer from the condition the organisation is established to service or is a charged recipient of the services being provided.

Guidance from the ACNC as to how this declaration will work in practice would be beneficial.

The reference to 'perceived conflict of interest' in this provision is also inappropriate. The governance standards are supposed to represent a minimum standard and therefore should remain with actual material conflicts of interest.

The standard should also clarify that a responsible entity may give standing notice of a conflict of interest in the manner set out in section 191 of the Corporations Act.

Business Judgement Rule

We strongly support the inclusion of Protection 2 (1) which has been based on the Business Judgment Rule set out in Section 180 (1) of the Corporations Act.

Given that the Business Judgment Rule in the Corporations Act has been the subject of judicial consideration in a number of significant cases, we suggest that to provide absolute clarity for "responsible entities" the protection's heading should expressly include the term "Business Judgment Rule".

We trust that our comments and recommendations on the proposed standards make a valuable contribution to the consultation process.

If you would like to discuss our submission in more detail please contact Steve Burrell, General Manager Public Affairs and Communications, on 02 8248 6627 or at sburrell@companydirectors.com.au.

Yours sincerely,

John HC Colvin
CEO and Managing Director