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15 February 2013

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Dear Colleagues

Governance standards for charities registered with the ACNC - consultation paper

Gadens lawyers acts on behalf of various charities and not-for-profit entities.

We welcome the opportunity to comment on the proposed governance standards to apply to charities registered with the Australian Charities and Not-for-Profits Commission (ACNC).

Our key concern is that governance standards 4 and 6 as presently drafted are onerous for charities and we do not think they should be included in their current form.

Furthermore, we think the approach to governance standards presently adopted is not the optimal method to achieve the objectives of the ACNC Act. The current approach to the governance standards places too much emphasis on achieving object 15-5(1)(a) of the ACNC Act (being "*to maintain, protect and enhance public trust and confidence in the Australian not-for-profit sector*") so that it is being implemented in a way which could undermine object 15-5(1)(b) of the ACNC Act (being "*to support and sustain a robust, vibrant, independent and innovative Australian not-for-profit sector*"). We further comment on this in section 7 below.

1. Governance Standard 1: Purposes and NFP character of a charity

The contents of this governance standard must already be complied with by charities in order for the charity to obtain and maintain their charity tax concessions. We do not think this governance standard in practice achieves anything over and above what is already required of charities.

For example, the ATO requires charities to demonstrate, including by reference to an entity's governing rules, its purposes and character as a charity and a not-for-profit entity before the charity can be endorsed to receive charity tax concessions. Also, as the ACNC register is to include information on the governing rules of a registered charity, the proposed requirement that the charity will make information about its purposes available to the public has already been complied with according to the notes in the Consultation

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Paper.

2. *Governance Standard 2: Accountability to members*

It is our experience that most charities replicate the minimum protections for members in the *Corporations Act* or the incorporated association legislation in its governing rules or otherwise include other minimum protections in its governing rules for the purposes of accountability and transparency to their members.

A charity's governing rules are important. The governing rules, amongst other things, should govern the relationships between the charity and each member, between members, and between the charity and its directors/responsible entities.

Governing rules which have been properly considered are therefore vital to assist charities achieve good corporate governance as well as, amongst other things, ensure the long term sustainability of a charity.

Accordingly, rather than relying on a charity's compliance with governance standard 2, we think the ACNC should provide assistance to charities so that they can have in place appropriate governing rules on registration and have best practice corporate governance policies over time. This encourages charities and their members to resolve any problems or disputes internally using the mechanisms set out in the governing rules and other policies, rather than members possibly seeking the ACNC Commissioner to intervene using its enforcement powers at first instance because a member is unsure what they can compel a charity to do.

We note that the ACNC has provided examples in the draft governance standards of the steps a charity may take to ensure accountability and transparency. We think there is some uncertainty whether the taking of those steps are sufficient alone to satisfy the "reasonable steps" test, or whether depending on the particular charity it could be required to "do more". If this was the case, that would be an unsatisfactory position as this is an additional obligation on charities which does not currently exist.

3. *Governance Standard 3*

We have no comments on this proposed standard.

4. *Governance Standard 4*

With respect, whilst we understand the importance of responsible financial management of a charity's resources, we do not think it is appropriate to impose governance standard 4 on charities.

Governance standard 4 is a new duty on charities which does not currently exist at law as a standalone obligation. We note that the obligation has been placed on the charity, rather than the directors/responsible entity consistent with the powers under the ACNC Act however, governance standard 4 is not an existing standalone obligation on directors either. As noted in the Consultation Paper:

"There are various existing obligations for NFP entities that encompass managing financial affairs. The Corporations Act 2001 manages financial affairs largely through directors duties, including the requirement that directors of corporations must exercise their powers and discharge their duties with the degree of care and diligence a reasonable person would exercise in the circumstances of that corporation and director"

Governance standard 6 already imposes an obligation on the charity to ensure their directors/responsible entities are complying with certain duties which would encompass the management of the financial affairs of the charity.

There has been significant consideration by the Courts of the duties of directors (whether under statute or general law) and their responsibility in relation to the financial affairs of the company, including their power to delegate certain responsibilities and ability to rely on information provided to them. Imposing a new standalone obligation upon a charity creates uncertainty in an area of law which has already been given significant consideration by the Courts.

5. *Governance Standard 5*

We have no comments on this proposed standard.

6. *Governance Standard 6*

In our view, this governance standard needs further development. It should not be included in its current form.

The imposition of an obligation on a charity to take "reasonable steps" to ensure that its responsible entities are complying with the responsible entities' duties to the charity is not appropriate in our opinion. The Consultation Paper states that the obligation to comply with the governance standard has been placed on the "*registered charity, rather than the responsible entity, consistent with the powers in the ACNC Act*".ⁱⁱ However we think this should not occur for the following reasons:

- (a) The duties set out in governance standard 6 are duties ordinarily owed by the director towards the company or charity. It is inappropriate for a charity to be required to monitor and also be responsible for a breach of a director's duty which is ultimately for the benefit of the charity.
- (b) The ACNC should be seeking to preserve, and not erode, the right of the charity as plaintiff to enforce the duties owed by a director to it, particularly given that on 1 July 2013 certain director's duties under the Corporations Act are intended to be switched off.
- (c) Now that certain duties under the Corporations Act will no longer be applicable to charities incorporated as companies, the statutory derivative action under Part 2F.1A of the Corporations Act is no longer available for members of charities to commence action on behalf of the company for breaches of a director's statutory duty. Given our comments in paragraphs (a) and (b) above, we query whether this is intended to be the effect of the governance standards.
- (d) Charities are being imposed an additional obligation under governance standard 6 which does not presently exist under the Corporations Act (if they are incorporated as companies) or general law on charities.

There also appears to be an anomaly arising from the carve out of the director's duties under the Corporations Act and its quasi re-insertion into the ACNC legislation/governance standards. The duties which no longer apply to charities registered under the Corporations Act from 1 July 2013 are sections 180 to 183 and 185 to the extent it relates to sections 180 to 183. Those duties apply to directors and officers of the corporation. However, governance standard 6 and the ACNC legislation appear only concerned with the director and not the officer. This means that officers of registered charities from 1 July 2013 who are not directors are not bound by (what would normally be) their statutory obligations under the Corporations Act. We query whether this consequence is intended. We note that the concept of "officer" only appears in section 85-10 of the ACNC Act relating to the ability of the ACNC Commissioner to give directions to such persons.

We note there is confusion between the use by the ACNC of the term "responsible person" and "responsible entity". Both terms are being used by the ACNC in its documents. Responsible person is not defined in the ACNC legislation however it has been commonly used by the ACNC as a substitute for the

term “responsible entity” from time to time. For example, although the ACNC legislation requires charities under section 65-5 to notify it where an entity has “*ceased to be, or has become, a responsible entity of the registered entity*”, ACNC Form 3A (the relevant form to notify of this change) relates to notification of changes to the “responsible person” of the charity. We think there should be some consistency in the terminology used by the ACNC to avoid confusion.

7. General comments

We would like to provide some general comments on the framework which the ACNC governance standards are proposed to operate in.

The proposed governance standards substantially state what is already required at law of charities. Accordingly, we think there should be an approach adopted by Government which is aimed towards assisting and supporting charities have good corporate governance practices in place so that they are aware of and can meet their legal obligations, rather than a regime which is focused on mandatory compliance and enforcement.

It is already accepted that the majority of charities are already complying with the draft governance standards.ⁱⁱⁱ We also think that the majority of charities have a desire to have good corporate governance structures in place but lack the resources and knowledge to achieve this.

Given that is the case, we fail to understand the reasons for the unwillingness to adopt an approach similar to the ACNC’s counterparts overseas, such as in the UK^{iv}, Singapore^v and New Zealand^{vi} which do not require mandatory compliance to a specific set of governance standards and instead adopt a “if not, why not” approach to their model governance standards. ACNC’s overseas counterparts can therefore focus their energies and resources on assisting charities understand how to achieve good corporate governance rather than over regulation of the activities of charities.

It is also undesirable to place on charities an obligation to comply with specific governance standards when ASX listed companies are not similarly required to comply with the ASX good corporate governance principles and an “if not, why not” approach is also adopted in relation to ASX listed companies.

Also, a potential problem with the current approach is that there is a conflict between:

- (a) A desire to ensure registered charities have flexibility in determining how to comply with the governance standards based on their particular size and circumstances. Accordingly, the standards are drafted as “*principles-based in that the standards specify the outcome that registered charities need to achieve, rather than the mechanism that achieves it*”^{vii};
- (b) The Commissioner’s power to determine a charity’s compliance with the governance standards and his/her wide enforcement powers in the event of non-compliance; and
- (c) The lack of resources in the NFP sector to understand the NFP reforms and the need for charities to have guidance material on their legal obligations to ensure the charity understands their obligations, including the governance standards.

As the governance standards are based on principles, the ACNC Commissioner retains the ultimate power to interpret the meaning of the governance standards and enforce the governance standard based on its own interpretation. Charities will not want to be in breach of their legal obligations and therefore require assistance to understand their obligations but many lack the resources. The ACNC Commissioner has recognised this and has stated that it will “*release guidance material to assist registered charities in understanding and complying with the governance standards*”. Guidance by the Commissioner is needed otherwise the board or management committee of charities become uncertain of their obligations.

Uncertainty stifles and undermines a charity's charitable activities for fear of enforcement action by the ACNC Commissioner.

With respect, what this can lead to is a governance regime which in fact becomes prescriptive and therefore undermines the very purpose of having principles-based governance standards. The ACNC Commissioner has recognised the need for charities to have the flexibility to determine what is most appropriate for them to comply with the governance standards. Given the diversity of the not-for-profit sector, a rules-based "one-size fits all" approach would be clearly inappropriate. Yet we are concerned that the NFP sector's need for guidance will over time undermine the purposes of having principles-based governance standards. This is another reason why we prefer an approach to governance standards similar to that adopted by the Charity Commission for England and Wales and not a regime which requires mandatory compliance to governance standards.

We would be happy to elaborate of any of the points made in this submission should this be required.

Yours sincerely



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for **GADENS LAWYERS**

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- ⁱ *Treasury, Development of governance standards – Consultation Paper*. Commonwealth. December 2012 p. 16
ⁱⁱ *Treasury, Development of governance standards – Consultation Paper*. Commonwealth. December 2012 p. 22
ⁱⁱⁱ *Treasury, Development of governance standards – Consultation Paper*. Commonwealth. December 2012 p. 10
^{iv} The Charity Commission for England and Wales
^v Charity Council, Singapore
^{vi} Charities Commission New Zealand
^{vii} *Treasury, Development of governance standards – Consultation Paper*. Commonwealth. December 2012 p. 8