

Submission to the Treasury:

15 February 2013

Development of Governance Standards consultation paper

PilchConnect welcomes the opportunity to submit our views on the *Development of Governance Standards* consultation paper dated December 2012 (**Consultation Paper**). PilchConnect has been a strong supporter of the establishment of the Australian Charities and Not-for-Profits Commission (**ACNC**) and is pleased to have been involved in various consultations on the proposed governance standards, including the Not-for-Profit (**NFP**) Sector Reform Council roundtable in late 2012. PilchConnect believes that the standards proposed in the Consultation Paper (**Proposed Standards**) are a significant improvement on previous iterations and reflect the considerable work done by government and the sector to develop and refine draft standards since the Treasury's initial consultation in December 2011.

Against this background, we submit that further work on the Proposed Standards is needed to achieve a set of fair, practicable, conceptually-coherent governance standards for ACNC-registered charities. While we applaud the Government's commitment to 'principles-based' standards which reflect a minimum set of governance-related outcomes, we are concerned that aspects of the Proposed Standards would add unwarranted complexity to existing regulatory arrangements (rather than 'consolidate and deliver an element of consistency to'¹ existing frameworks, as is the stated aim). Importantly, we also consider that some of the Proposed Standards may operate in practice to deter people from being involved in governance roles within charities, especially small, volunteer-run groups with limited resources (which are the key groups we assist at PilchConnect).

We set out below some general comments followed by our views in relation to each Proposed Standard, together with recommendations. In summary, our principal submissions are as follows:

- **Proposed Standard 1** is acceptable, subject to improving its drafting and clarifying the scope.
- **Proposed Standard 2** is too vague: it needs further work to clarify the expected outcomes and to avoid the potential for inconsistent and/or burdensome application.
- **Proposed Standard 3** is unnecessary and inappropriate as a governance standard. Its reach and the powers conferred on the ACNC to take action under it are overly broad.
- **Proposed Standard 4** is acceptable, subject to improving its drafting and clarifying the scope, and provided it focuses on reasonable financial management.
- **Proposed Standard 5** is problematic in practice and unwarranted particularly for small charities.
- **Proposed Standard 6** is conceptually and practically problematic, and should be reconsidered.

About PilchConnect

PilchConnect is an independent NFP legal service for community organisations. We provide free/low cost legal assistance to small 'public interest' NFPs, and draw on empirical evidence and practical examples from our work with these groups in our submissions. See Appendix A for more information.

¹ Consultation Paper, page 8.

PART 1: GENERAL COMMENTS ON THE PROPOSED STANDARDS

The ‘principles-based’ approach is commendable but some standards are too high level

PilchConnect supports the Government’s ‘principles-based’ approach to governance standards. In our view however, the drafting of some of the Proposed Standards is too high level, making it difficult to understand their practical application and potentially leading to uncertainty for current and prospective charities. The high level principles-based approach also means that, at times, it is unclear how the Proposed Standards are intended to interact with other existing legal and regulatory requirements concerning governance-related issues.

Casting the Proposed Standards in very broad terms will require publication of clear guidance material to assist charities to understand how to comply with their obligations. It would be counterproductive for charities to wade through large quantities of guidance material in order to understand the practical steps required to comply with high level standards. This is particularly important for the small-to-medium charities with which PilchConnect generally works, many of which have extremely limited resources to apply to understanding new laws and requirements.

We also consider that the ‘objects’ of the Proposed Standards at times hinder the clear identification of ‘outcomes’ that are at the heart of the principles-based approach.² While the objects are useful aids to interpretation of the Proposed Standards in this consultation phase, they are not always clearly aligned with the overall objects of governance standards in section 45-5 of the *Australian Charities and Not-for-Profits Commission Act 2012 (ACNC Act)*, nor in some cases are they consistent with the overarching objects of the ACNC Act (which include the reduction of unnecessary regulatory obligations and the supporting of an independent Australian NFP sector).³ In our view, consideration should be given to removing objects from the standards, or at least ensuring they are drafted in a way that meaningfully elucidates the ‘principles’ and/or ‘outcomes’ to be achieved.

ACNC guidance material on governance standards will be critical but not legally authoritative

As a result of the principles-based approach, it will be critical for the ACNC to produce clear guidance to assist charities to understand what the standards require in practice. The non-binding nature of any guidance materials the ACNC produces in relation to the Proposed Standards is of note in this context. This is to be contrasted with publicly available Precedential Australian Tax Office (ATO) Views (such as rulings and ATO Interpretative Decisions) and which are regularly applied to private rulings made by the ATO. Precedential ATO Views and private rulings can reasonably be relied on by people or organisations, where the law is unclear or its effect is unreasonable. As the ACNC has no power to make rulings or determinations of this nature with respect to the Proposed Standards, charities seeking to rely on ACNC guidance materials might never have complete comfort that their activities or governance

² ‘Principles-based standards’ are defined on page 5 of the Consultation Paper as specifying ‘an outcome’ rather than the means to achieve that outcome.

³ See ss 15-5(1)(b) and (c) of the ACNC Act.

meet the legal requirements imposed by the Proposed Standards. This underscores the importance of developing clear, minimum standards for charities that are easy to understand and apply in practice.

Drafting of the standards must be plain language

While we recognise that it is a difficult balance to achieve, key terms used in the Proposed Standards is very technical and is likely to be inaccessible to volunteers in small charities without legal assistance (for example, legalistic terms such as ‘fiduciary duty’ and ‘indictable offence’).

We reiterate our point made in various submissions on the ACNC legislation⁴ that the terms ‘registered entity’ and ‘responsible entity’ are extremely confusing, and in our experience are inhibiting the engagement of parts of the NFP sector with the reform process. We consider that the term ‘responsible entity’ is particularly problematic, and should be reconsidered across the ACNC legislative framework.⁵

The application of some standards to charities, not their directors, is problematic

Some of the Proposed Standards place obligations on registered charities in relation to the conduct of their directors (‘responsible entities’). While we acknowledge this approach is considered necessary because of constitutional limitations of the ACNC regulatory framework, we submit that imposing obligations on a charity to effectively ‘regulate’ the conduct of its directors is problematic. This approach could lead to charities having to divert their limited resources away from core work, in order to take action against a director (eg, in the event of a director’s breach of duty that is covered by Proposed Standard 6), when potentially a more appropriate mechanism would be for the ACNC (or another regulator if necessary) to take action against that director personally.

In this context, we have concerns with the ‘turning off’ of certain provisions of the *Corporations Act 2001* (Cth) relating to directors’ duties, when the governance standards come into effect. It is curious that, at a time when other jurisdictions are moving to make NFP directors’ duties consistent with the duties in the Corporations Act (see eg Victorian incorporated associations legislation, commenced in November 2012), those very provisions are proposed to be turned off for companies that are registered charities. This approach does little to streamline approaches across the states and territories or promote consistency across incorporated structures.

We note that, in several cases, the Consultation Paper refers to provisions of the Corporations Act as examples of what will comply with the Proposed Standards, when it is these very provisions are being ‘turned off’ when the governance standards commence.

⁴ See PilchConnect’s submissions at <http://www.pilch.org.au/federalreform/>

⁵ In this submission, we use the terms ‘directors’ and ‘committee members’, instead of ‘responsible entities’.

PART 2: SUBMISSIONS ON THE PROPOSED STANDARDS

Proposed Standard 1: Purposes and NFP character of a charity

PilchConnect supports the intention behind Proposed Standard 1 as it seeks to ensure that registered charities commit to their purposes and NFP character. Improvements should be made, however, to the mechanics and language of the Proposed Standard as outlined below.

Language used in Proposed Standard 1

Clause 2(b) of Proposed Standard 1 requires registered entities to make information about their purposes available. What constitutes ‘information about’ a charity’s purposes is potentially extremely broad, and for certainty should be confined. Presumably, ‘information about’ a charity’s purposes would include the charity’s rules and mission statement; it could also include other types of information such as resolutions or statements of the committee, minutes of a discussion about strategic planning and purposes, previous statements of purposes, and a range of other historical or current documents. The simplest and clearest amendment would be to confine clause 2(b) so that a charity’s *purposes* must be publicly available (eg. in their rules/constitution, and charities without governing rules could be required to make available the purposes that were provided to the ATO or ACNC upon receiving tax concessions and/or registration). Alternatively, clause 2(b) could be followed by examples of ‘information’ would satisfy this requirement.⁶

Clause 2(b) also requires registered charities to ‘make’ information about their purposes available to the public. This suggests that charities must proactively do something in order to satisfy the requirement. However, the note to Proposed Standard 1 and page 12 of the Consultation Paper states that if information about a registered charity’s purposes is on the ACNC Register, this would satisfy the requirement without the need for the charity to take any further action. It is therefore unclear whether, for example, if a member of the public (eg a donor) asks the charity for specific information about its purposes, the charity would need to give that information to the person, or whether it would be enough to say the information is on the ACNC register, or that there is information on the charity’s website.

We also note there is little guidance in the Proposed Standard or Consultation Paper about what would be required to ‘comply with’ a charity’s purposes (and what would constitute a breach of this standard). Further clarity would be useful to assist charities to understand what is required in practice.

Uncertainty as to the meaning of ‘NFP entity’

Proposed Standard 1 requires registered charities to demonstrate and comply with their character as a ‘not-for-profit entity’. The Proposed Standards leave this term undefined. It appears the term would take its meaning from clause 44 of the *Tax Laws Amendment (Special Conditions for Not-for-profit*

⁶ The Corporations Act 2001 uses the phrase “information about” a number of times, and the phrase is sometimes followed by specific examples that illustrate how to satisfy the requirement to make information about a particular thing available (see, for example sections 671B and 672DA Corporations Act).

Concessions) Bill 2012 (Tax Laws Amendment Bill), if passed - in relation to this proposed definition, we refer to the reservations noted in the parliamentary committee processes for the Tax Laws Amendment Bill and urge the Government to reconsider including the definition as proposed. In our view, any statutory definition of 'NFP entity' should be further developed and included in the proposed statutory definition of charity legislation, which is expected to be drafted later this year.

Recommendations

- *The reference in clause 2(b) of Proposed Standard 1 to 'information about' purposes should be deleted; alternatively clause 2(b) should be redrafted to clarify what will amount to 'information about' a charity's purposes, and require charities to take 'reasonable steps' to achieve this.*
- *Guidance on how a charity's activities would satisfy/breach clause 2(c) should be included in a Note to this standard.*
- *Any statutory definition of 'NFP entity' should be postponed until the proposed charity definition legislation is drafted.*

Proposed Standard 2: Accountability to members

PilchConnect supports the objectives of accountability and transparency for member-based charities. However, the current drafting of Proposed Standard 2 is too vague, and revisions are needed to ensure the standard provides a sound basis for clear and appropriate accountability/transparency 'outcomes' for charities with members.

Lack of clarity about what is required in practice

The Proposed Standard requires member-based charities to take 'reasonable steps' to 'ensure' accountability to members and that members can raise concerns about a charity's governance. How charities can comply with this standard is unstated and for the charity to determine according to its resources and circumstances. While Note 1 states that that holding an AGM, electing directors, and reporting to members are steps that a charity 'may' take to satisfy the standard, it does not state whether these are expected, or required, or what would otherwise satisfy the Proposed Standard.

Clarity in this Proposed Standard is particularly important for 'small' charities that are not under an obligation to submit financial statements to the ACNC. It is presumed that in many cases, 'accountability to members' will refer to financial transparency, and some level of reporting is likely to be required to meet this standard. Guidance for small charities on the requirement to report (if any) and the form of such a report would be essential to clarifying this Proposed Standard.

For these reasons, we submit that the standard should specify minimum accountability 'features' (eg, account to members, at least yearly, on activities and finances) to give charities comfort as to what is expected.

The need to ensure a consistent, proportionate, minimum standard for member-based charities

What is required in relation to Proposed Standard 2 appears to depend on a charity's legal structure. The Consultation Paper states that if a charity complies with relevant provisions in the Corporations Act, *Corporations (Aboriginal and Torres Strait Islander) Act 2006 (CATSI Act)* or incorporated associations legislation, it would be taken to be complying with Proposed Standard 2. In our view this may not always result in the types of accountability and transparency that appear to be contemplated by the Proposed Standard - for example, an incorporated association could adhere to its statutory requirements but still neglect to fully inform members of certain decisions or strategies (see case study example below). It is unclear how the ACNC would propose to deal with such situations.

Case Study example: Challenging the governance of a Victorian incorporated association

The Weekend Learning Society is a member-based charity registered with the ACNC and an association incorporated under the Associations Incorporation Reform Act 2012 (Vic). The Society has its own rules that were written by a former member a number of years ago.

Billy is a new member of the Society, and has taken a keen interest in the governance of the Society. Billy thinks that the performance of the Society's current committee is below the expected standard of competent committee member. Billy contacts the Society's Secretary, Joel, and asks how members can call a meeting to discuss the committee's performance – saying that, according to ACNC Governance Standard 2, the Society must ensure it is accountable and transparent to its members. Billy tells Joel that he has the support of a number of other members, who agree that a meeting should be called.

At the next committee meeting, Joel asks the committee how a member can call a general meeting. The committee members read over the Society's rules and agree there is nothing in the rules that confers power on members to call a meeting. The committee looks at the Associations Incorporation Reform Act and cannot see anything there that allows members to call meetings. Joel understands that Governance Standard 2 will be satisfied if the requirements of the Associations Incorporation Reform Act are met. The committee agrees that there is no need to call a members' meeting as a result of Billy's request.

Billy contacts the ACNC to complain that the Society is in breach of Governance Standard 2, saying that the committee has not given the members opportunity to raise concerns about its governance.

For charities that are regulated by the Corporations Act, the 'turning off' of Division 2 of Part 2G.2 relating to meetings and notifications will mean they must determine themselves (presumably via their constitution) how they would achieve compliance with Proposed Standard 2. Likewise, charities that are unincorporated would need to think about what steps or new procedures they should adopt to comply with Proposed Standard 2. Given that compliance with the requirements of the Corporations Act, CATSI

Act or incorporated associations is said to satisfy the Proposed Standard,⁷ charities would be likely to simply refer back to these requirements to understand and implement (and potentially ‘cherry pick’) mechanisms which are thought to be required. It is likely that some companies limited by guarantee would simply amend their constitutions to re-instate the provisions of the Corporations Act which have been ‘turned off’ (for the sake of certainty of compliance), which in our view would involve pointless red tape and should be avoided.

Finally, we note that while accountability and transparency to members is a critical part of good governance, consideration ought to also be given to the level of accountability afforded to a charity’s non-member stakeholders, such as its clients, supporters and donors. This is also an important step in ensuring public trust and confidence in a charity that is providing services to those outside of its membership, and overlaps with the intent and effect of Proposed Standard 1.

Recommendation

- *Proposed Standard 2 should be redrafted to more clearly articulate what is required. Clear and proportionate minimum outcomes should be developed and included in the Proposed Standard.*

Proposed Standard 3: Compliance with Australian laws

While few would argue that there ought to be a prohibition on charities engaging in serious illegal activity, we query the need for a governance standard to explicitly require this. We submit that such matters are better dealt with through existing legislative frameworks. Ongoing compliance with Australian law is a standard expected of registered charities, and the ACNC (through its information sharing powers) would be capable of referring illegal activity to the relevant enforcement body. Such body would likely be in a better place to assess/investigate the matter and impose sanctions where appropriate.

We note that this Proposed Standard is broadly framed and applies where a charity has not actually been charged with an indictable offence. We submit this is inappropriate, and challenges the rule of law in that a charity is able to be sanctioned without the benefit of a presumption of innocence. We therefore do not agree with this Proposed Standard’s application to circumstances that ‘may’ result in an indictable offence or civil penalty, and submit this reference should be removed.

The rationale for Proposed Standard 3 is not clearly evident in the Consultation Paper, although we understand it is desired in order to provide the ACNC with a triggering mechanism to take enforcement action against a charity if it appears they have committed a serious breach of the law. We query whether this is an appropriate matter to be dealt with by governance standards (as opposed to in the ACNC Act itself). If the concern is that charities could potentially retain their charitable status despite the commission of a serious offence, in our view, this could be dealt with by ensuring the statutory

⁷ In particular, page 14 of the Consultation Paper states that compliance with the ‘turned off’ Corporations Act provisions would ensure compliance with Proposed Standard 2.

definition of charity contains appropriate exclusions for those entities acting illegally. This could be the subject of further consultation on the proposed statutory definition set to take place later in 2013.

The objective of this Proposed Standard can be achieved through a positive focus on assisting charities to comply with their legal obligations, with serious breaches of the law continuing to be addressed through existing enforcement mechanisms. If the Proposed Standard is retained, it could be expressed as requiring charities to take reasonable steps to maintain systems or processes to ensure ongoing compliance with laws. Coupled with ongoing guidance from the ACNC on how to maintain adequate review processes, this is likely to achieve the desired effect of maintaining public trust and confidence in the charitable sector, and would be similar to the approach taken by Proposed Standard 4.

Should this Proposed Standard remain, we submit that the term 'indictable offence' should be substituted with a more plain language phrase, or at least further clarified, similar to the approach taken in section 206B of the Corporations Act.

Finally, we note that the 'object' of Proposed Standard 3 does not appear to be properly aligned with the standard itself. While the 'object' makes two references to the protection of a charity's assets, the standard is solely concerned with illegal activity, regardless of the impact such offence has had on the assets of the charity. While it may often be the case that illegal activity adversely impacts on a charity's assets, there is a disconnect between that drafting of the 'object' and the standard itself in this regard.

Recommendations

- *Proposed Standard 3 should be deleted.*
- *If, however, the Proposed Standard is retained, it should be rearticulated as a standard that requires charities to take reasonable steps in relation to monitoring/assessing their compliance with laws.*
- *If, however, Proposed Standard 3 is retained more or less in its current form:*
 - *it should apply only where a charity has been found to have breached the law by relevant authorities,*
 - *the reference in the 'object' to the safety of assets should be amended for better alignment to the scope and subject matter of the actual standard, and*
 - *the term 'indictable offence' should be clarified.*

Proposed Standard 4: Responsible management of financial affairs

While we do not have major concerns about the intent of Proposed Standard 4, we submit it does little to add to obligations that directors are already under by virtue of their fiduciary duties, and obligations of member-based charities to account to members under Proposed Standard 2. The explanatory material in the Consultation Paper on this Proposed Standard refers to issues/requirements which, in our view, are properly described as aspects of directors' duties. We therefore query the need for this standard.

We appreciate that proper financial management of charities is critical to the public's ongoing trust and confidence in the sector. If a standard specific to financial management is to remain, it should be more clearly articulated and its scope defined. Practical guidance material on how to comply with this Proposed Standard would be particularly essential for 'small' charities that are not under an obligation to submit financial statements to the ACNC. It is presumed that 'responsible management of financial affairs' would require some level of financial reporting and record-keeping, and practical guidance for small charities on these aspects would be essential to clarifying this Proposed Standard.

In our view, the explanatory material in the Consultation Paper interprets the Proposed Standard too broadly and is potentially overreaching. In particular, we are concerned with the focus on insurance and risk management, rather than financial transparency and procedural safeguards. While insurance and risk management are important things to consider in the overall financial management of a charity, the Proposed Standard confuses the obligation to exercise reasonable judgment on fiscal decisions and maintain adequate financial safeguards, with the issues of appropriate risk management procedures. In our view, the example provided in the Consultation Paper is unhelpful, and unnecessarily broadens this standard into a legislative obligation to identify and mitigate organisational risk, whether financial loss, physical damage or other.

We also note that the phrase 'responsible manner' presumably requires a standard higher than 'reasonable'. We are not convinced this higher standard is appropriate or necessary. In our experience, NFPs are often very risk averse when it comes to financial management, and we have some concern that a requirement to manage finances 'responsibly' may inhibit reasonable risk taking and innovation.

Recommendation

- *If it is retained, Proposed Standard 4 should:*
 - *be drafted more clearly to provide practical notes on what is required to be compliant, with reference to the size and assets of each charity,*
 - *focus on proper financial management procedures, rather than on risk management and insurance, and*
 - *refer to 'reasonable' management of financial affairs.*

Proposed Standard 5: Suitability of Responsible Entities

While we are sympathetic to the intention behind this standard, we do not believe Proposed Standard 5 is warranted given its practical impact. We are concerned that the Proposed Standard would be unduly onerous, particularly for small charities, and we are not convinced that the risk sought to be addressed by the Proposed Standard justifies the burdensome and off-putting processes it would involve.

Practical issues

We recognise that an important aspect of good governance is having suitable people on the governing body. However we are concerned that the practical requirements behind Proposed Standard 5 will

deter people from taking up governance positions within charities, particularly volunteers in small grassroots organisations who do not have a sophisticated understanding of legal terms/processes. We note that, in practice, a registered charity may need to take the following steps to check whether the conditions in clause 3 of Proposed Standard 5 are met, in respect of each director/potential director:

- conduct a search of the ASIC Disqualified Persons Register;
- obtain from the director/potential director a written declaration that they have not been convicted of relevant offences under the Corporations Act or offences involving dishonesty, are not bankrupt, are not subject to a personal insolvency agreement etc; and
- search the ACNC Disqualified Responsible Entities Register established under subdivision 45-D.

This is a daunting set of tasks for a small charity to undertake. The Proposed Standard may also have practical difficulties, in that it appears a charity would need to obtain a potential directors' declaration (and undertake ASIC/ACNC checks) *before* that person assumes their role (see example on page 20 and commentary at the top of page 21 of the Consultation Paper). These problems are illustrated by the case study example below.

Case Study example: Proposed Standard 5 in practice for a small regional charity

Jane recently joined her local environment group, Green Leaves, which is a small volunteer-based charity registered with the ACNC. Jane is passionate about the environment, and an excellent organiser with great fundraising ideas for the group. At each year's AGM, Green Leaves struggles to get nominations to fill its committee roles, and for the third year in a row, no one puts their hand up for the position of Secretary. Jane is encouraged by her fellow members to nominate.

Jane nominates for the Secretary position at the AGM. The group is very relieved. Glenda, the group's chairperson, confirms that as no one else is nominated, Jane has got the gig!

A week later, Glenda contacts Jane to confirm her name and any former names, saying she had not realised the group now has to undertake checks of all new committee members to make sure they are not disqualified from managing corporations. Jane should also have signed a declaration before she was elected, confirming that she has not been convicted of certain offences and saying something about a 'personal insolvency agreement'. Jane was unaware of these requirements, and is extremely distressed as a number years ago when living in the United Kingdom, she had to go to court for a minor criminal matter. Jane recalls that a conviction was recorded, although she didn't have to go to jail, and has had no issues since.

Jane does not know whether her past will prevent her from being on the committee of Green Leaves, but she certainly doesn't want everyone to know about it. She lives in a small regional community, and fears others will judge her (even though the matter happened a long time ago in very complicated circumstances). To avoid the risk of being refused the Secretary role and the possibility of having to reveal her conviction, Jane tells Glenda that she has changed her mind and does not want to be the Secretary or involved in the group's committee.

There are other practical questions that are likely to be asked by the small-to-medium charities we work with. They include, for example, the following:

- *If we don't appoint/elect a director before the checks and declaration are completed, what happens in the meantime?* We note that many charities' governing rules require a certain number of directors, so appointing a director pending the satisfactory completion of suitability checks could result in a charity being non-compliant with its rules.
- *What happens if we check the ASIC and ACNC Registers and the person is listed as a disqualified person?* Clause 5 of Proposed Standard 5 does not set out a clear procedure for how a charity is to obtain the Commissioner's permission to allow an individual who does not meet the relevant conditions to be a director of a charity. The Consultation Paper (at page 21) contemplates that a charity would need to 'seek an exemption from the Commissioner to so appoint the person' - again, this suggests Proposed Standard 5 requires the relevant steps to be undertaken *before* the person is appointed, which may not always be practicable. Obtaining approval from the Commission would also be an intimidating proposition for many small charities, and would involve the charity having to deal with yet more administrative/regulatory complexity.

One possibility of alleviating this Proposed Standard's burden on small-to-medium charities is to consider applying it only to large registered entities, as defined in the ACNC Act. In our view, such an approach would be consistent with the overarching goal of ensuring public trust and accountability, as in the majority of cases it is the large charities that are in receipt of significant levels of public funds, and are therefore more appropriate to have the composition of their governing body more closely scrutinised.

Drafting issues

Should Proposed Standard 5 remain, we note the following issues with its current drafting:

- The Proposed Standard could be expressed in simpler language - for example, clause 2 cross-refers to clause 3, which is 'subject to' clause 5, which in turn is 'despite' clause 3. There are also cross-references to clause 4 in clauses 3(b) and 6. We consider that if this standard is retained, its drafting (and the notes which accompany it)⁸ will need to be reconsidered.
- The word 'ensure' in clause 2(a) imposes too high an obligation on charities and it is not clear whether it requires a charity to assess a potential director's suitability before he/she assumes a governance position.⁹ If this standard remains, we believe it should be redrafted to require a

⁸ The 'Examples' in this Proposed Standard are the only instance of such in the draft standards – other explanatory/exemplary material in the Proposed Standards are called 'Notes'. It is not clear whether (or how) this 'Example' differs from the 'Notes' and we suggest a uniform approach across the standards to avoid ambiguity. We also consider the 'Note' below clause 2 is not expressed in plain language and query whether it is necessary.

⁹ Clause 2(b) imposes the additional obligation 'after taking those steps...', which lends weight to the interpretation of clause 2(a) as an initial 'point in time' requirement.

charity to take reasonable steps to 'be and remain satisfied' that directors meet the relevant conditions. This approach would be much simpler and remove the need for clause 2(b)(i).¹⁰

Comments on the proposed Disqualified Responsible Entities Register

In our view, the disqualification of directors and the maintaining of a register would be more appropriately dealt with in the ACNC Act itself, rather than by way of a governance standard. Should Proposed Standard 5 remain, we note the following issues about the proposed Register:

- The regulation is drafted in a relatively ' cursory' manner and in our view should be expanded to include appropriate mechanisms to ensure fairness for those listed – for example:
 - the Commissioner should have discretion as to whether to list a person on the Register who was suspended for a period of time, where that period has concluded;
 - the Commissioner should have discretion to remove a listed person after a certain period has passed; and
 - the Register should note the type of disqualification that the person was subject to (eg suspension or removal), the date of suspension or removal, and if the person was suspended the period for which they were suspended.
- It is not clear how the Register will relate to the ACNC Register. If the two registers are to be linked, there is the potential for entries on the Disqualified Responsible Entities Register to prejudicially affect charities. This will need further consideration should the proposed regulation be retained.

Recommendations

- *Proposed Standard 5 should be deleted.*
- *If, however, Proposed Standard 5 is retained:*
 - *it should be apply to large registered charities only*
 - *clause 3 should be simplified, so that it imposes an ongoing obligation on the charity to take reasonable steps to 'be and remain satisfied' that directors are not disqualified, and*
 - *the basis for and operation of the Disqualified Responsible Entities Register should be reconsidered.*

¹⁰ As currently drafted, clause 2(b)(i) requires the charity to 'be, and remain, satisfied' that each director meets the conditions. We note that this part of the standard requires more than taking 'reasonable steps'. This sub-clause should be modified so that a charity is required to take 'reasonable steps' in respect of all three elements of the standard in clause 2.

Proposed Standard 6: Duties of Responsible Entities

We submit that Proposed Standard 6 is problematic, both from conceptual and practical points of view. It also raises concerns about the impact of ‘turning off’ of certain Corporations Act provisions which currently apply to directors of companies that are registered charities. These issues are discussed below.

Conceptual issues

Proposed Standard 6 imposes a requirement on the charity to take reasonable steps to ensure that its directors are subject to, and comply with, a number of stated duties. Crucially, the Proposed Standard imposes no obligation on the directors (or ‘responsible entities’) of registered charities.

The Consultation Paper states (at page 22) that the proposed duties would be ‘substantially the same as the duties of directors under the Corporations Act 2001... [and] apply in some cases by statute to incorporated associations.’ We submit this is not the case: the entity bound by Proposed Standard 6 is the charity itself, not the directors; thus Proposed Standard 6 imposes quite a different set of obligations to those imposed by directors’ duties under the Corporations Act or otherwise.

That the standard is imposed on the charity itself also gives rise to problems in applying the proposed protections under subdivision 45-C. In our view, these provisions do not sit comfortably with the requirement on a charity to take ‘reasonable steps’ and in effect require the charity itself to assess whether a protection applies. A charity must ‘have regard to’ factors which would usually be the province of a regulator/independent decision maker, without a regulator’s investigatory powers or associated legal frameworks. Small charities without access to legal advice are likely to be reluctant to and rely on their own conclusions as to whether, for example, the business judgment rule is met. This will mean additional work for the ACNC (as they will be called on to provide advice to charities on the application of these provisions), as well as significantly increase the compliance burden for charities themselves.

We recognise the constitutional barriers to the ACNC taking enforcement action against directors of some types of charities. With this in mind, we form the view that it would be preferable for the standard to cross-refer to duties *already imposed on directors*, whether by statute, common law or otherwise – rather than overlay additional new obligations on charities that require them to take steps to ensure directors are ‘subject to’ duties which are similar to (but not the same as) the Corporations Act directors’ duties or duties imposed by state-based incorporation regimes or at common law. We also note that there is no requirement on the charity to enforce a duty or remedy a breach: only to take reasonable steps.

Practical issues with the term ‘subject to’

The phrase ‘subject to’ in clause 2 is unclear. Our first concern with this wording is that it is not plain language; secondly, that it is not clear what is required of charities in practice – would a charity be required to legally bind directors in order to ‘ensure’ they are ‘subject to’ the duties? Would a verbal

agreement be sufficient (if noted in the minutes)? How should charities reconcile differences between the duties their directors are already under (eg under legislation) and the duties as expressed in (a) – (f)?

If the term ‘subject to’ requires the charity to legally bind directors, the question arises as to how this should be done. If the duties apply by legislation, then this would seem to be sufficient to ensure that directors are ‘subject to’ the duties (however this would not be the case for companies limited by guarantee, because of the ‘turning off’ of Corporations Act directors’ duties). If the duties are not all applied by legislation (or if there are inconsistencies), then a charity may need to resort to the following steps:

- *Specifying the duties in the charity’s governing rules.* If this approach were taken, most charities would need to amend their rules – a potentially costly and time-consuming process which we do not recommend.
- *Requiring directors to enter into a deed, by which they agree to be bound by the duties.* As discussed above in relation to the declaration under Proposed Standard 5, this is likely to be a daunting and frightening prospect for many, and certainly does not reduce red tape for the charity.
- *Reply on common law duties.* However at common law, there is no clear separate duty to prevent insolvent trading, so to be ‘on the safe side’ charities would need another mechanism to ensure its directors are also bound by this specific duty (unless this duty is included in legislation - eg. Corporations Act s 588G for companies).

Each of these approaches has problems and in our view none are desirable.

We note the consultation paper suggests that a letter of appointment, board charter or code of conduct for directors would suffice. However we submit that it is not clear these would meet the standard on the wording of the Proposed Standard itself.

Other drafting issues

Should the Proposed Standard be retained, we make a number of other observations on its drafting:

- The object in Proposed Standard 6 is unnecessarily complex. The term ‘fiduciary relationship’ (and the hypothetical way it is used in clause 1(a)) is confusing and not plain language. The word ‘if’ suggests that the directors of a charity and the charity itself are not in a fiduciary relationship – it is well established that they are. In our view, the object should be simply to ensure that directors are acting in accordance with the duties they are already under, either at common law or via statute or otherwise.
- Key terms in the Proposed Standard are undefined - ie, ‘related party transaction’. Presumably, the intention is that this term would have the same definition as in the Corporations Act. If so, it may be useful to clarify that the Corporations Act definition applies (as is done with ‘insolvent’).
- While most of the duties under this Proposed Standard substantially mirror the directors’ duties in the Corporations Act, clause 2(a) and 2(e) are expressed in slightly different language. The significance of these ‘points of departure’ with Corporations Act language are not explained in the Consultation Paper, and the differences are likely to cause confusion. For example:

- Clause 2(a) requires directors to act with the degree of care and diligence that a reasonable individual would exercise if they were ‘a responsible entity of the registered entity’. On page 25, the Consultation Paper implies that the circumstances of the charity (ie. small or large) will be relevant to assessing a directors’ compliance with this duty, whereas the example at the bottom of page 25 proceeds on the basis that the legal/accounting qualifications of the director are relevant (ie, the skills of *a particular director*). We submit that, for clarity, this standard (if it is retained) should adopt the language of the Corporations Act s 180 to clarify that both the circumstances of the charity, and the responsibilities of the particular director, are to be taken into account.
- Clause 2(e) of Proposed Standard 6 (concerning ‘perceived or actual material conflicts of interest’) differs from sections 191 and 195 of the Corporations Act. Under clause 2(e) of Proposed Standard 6, directors of charities must disclose to the directors perceived or actual material conflicts of interest. In contrast, sections 191 and 195 of the Corporations Act set out a more comprehensive process, and include a number of ‘carve outs’ when disclosure is not required.¹¹ We submit that these differences may result in unintended consequences when applying the standard in practice.

Should there be extra protections for volunteer directors?

We do not support additional protections/‘safe harbour’ for volunteer directors. The standards should impose minimum requirements that are capable of being satisfied by directors of all charities (whether or not they are paid).

Issues with the ‘turning off’ of certain Corporations Act provisions applying to directors

As discussed above, when the Corporations Act directors’ duties are turned off on 1 July 2013, there will be a ‘gap’ in regulation of directors of charities that are subject to the Corporations Act. The statutory duties will no longer apply, and Proposed Standard 6 does not ‘do the work of’ (or replace) those provisions. The result is that there will be no regulatory mechanism to take action against a director of a charitable company who is in breach of their duties – the ACNC will only be able to act where the *charity itself* had failed to take ‘reasonable steps’ to ‘ensure’ that director is ‘subject to’ the relevant duties.

This is a significant backwards step. One of the main reasons that directors’ duties were introduced into legislation (such as the Corporations Act, see also Vic incorporated associations laws) was to clarify the scope and application of the relevant duties, and to provide for intervention and enforcement by a regulator in the event of breach. While common law directors’ duties will continue to apply to directors, the scope of these duties is not always clear and court action by the charity (or another party with standing) would be required to enforce them. Such proceedings are traditionally (and are likely to continue to be) extremely rare in the not-for-profit/charitable context, and involve significant resources.

We note the duty to prevent insolvent trading (s 588G) is proposed to remain applicable to directors of charities incorporated under the Corporations Act. This means that directors will continue to be subject

¹¹ See s 191(2) of the Corporations Act.

to this statutory duty under the Corporations Act, while others (ss 180 – 183) will be turned off and fall back to common law (and whatever terms the charity itself is able to achieve). This is an extremely confusing and unnecessarily complex situation.

For these reasons, we urge the Government to delay the ‘turning off’ of the directors’ duties in the Corporations Act. While ideally the ACNC would have power to enforce these duties against individual directors (cf ASIC) – and options to accomplish this should be further explored – we see little point in proceeding until a more workable regime can be properly achieved.¹²

Recommendations

- *Proposed Standard 6 requires further conceptual consideration and should not be implemented in its current form.*
- *If, however, a standard applying to registered charities is retained, Proposed Standard 6 should be redrafted along the following lines:*
 - *“A registered entity must take reasonable steps to ensure its responsible entities are aware of their obligations to comply with the duties owed by those responsible entities to the registered entity.”*
- *The ACNC (Consequential and Transitional) Act should be amended to defer the commencement of the ‘turning off’ of Corporations Act directors’ duties, and options should be explored to:*
 - *‘turn on’ equivalent directors’ duties for responsible entities/directors of registered charities that are regulated by the Corporations Act, which are enforceable by the ACNC; and/or*
 - *delegate or confer ASIC’s powers to the ACNC to enforce directors’ duties against responsible entities/directors of registered charities.*

Conclusion

Thank you for the opportunity to contribute to this consultation. We would be happy to elaborate on any of the issues raised in this submission on request.

Yours sincerely,



Juanita Pope
Director: PilchConnect
Phone: (03) 8636 4423
juanita.pope@pilch.org.au

Nathan MacDonald
Manager - Advice: PilchConnect
Phone: (03) 8636 4428
nathan.macdonald@pilch.org.au

Stephanie Tonkin
Senior Lawyer: PilchConnect
Phone: (03) 8636 4430
stephanie.tonkin@pilch.org.au

¹² See also PilchConnect’s forthcoming submission in response to the Council of Australian Governments’ Regulatory Impact Assessment.

APPENDIX A

About PilchConnect

PilchConnect is an independent, specialist community legal service that provides not-for-profit (NFP) organisations with access to free or low cost legal help (information, advice and training). We support small-medium NFP community organisations to be better run. We do this because when organisations are well run, they are more likely to achieve their mission, and trust and confidence in the NFP sector is likely to be improved.

By supporting NFPs in this way, we aim to contribute to a better civil society with more connected communities.

We fill a niche role; sitting between regulators and the private legal profession. As an independent, sector-based intermediary we understand the practical constraints that small community organisations operate under, and are trusted by them to provide practical, NFP-relevant legal help or direct them to other assistance. We often help organisations work out if they really do have a legal problem, how serious it is and what possible next steps are. We prioritise NFPs that assist marginalised and disadvantaged people and in rural and regional areas.

Our submission work is based on empirical evidence and practical examples drawn from our legal inquiry, advice and case work.