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Submission on Development of Governance Standards Consultation Paper

Contents

Background

The St Vincent de Paul Society ("the Society") is a respected lay Catholic charitable organisation operating in 148 countries around the world. In Australia, we operate in every state and territory, with more than 50,000 members, volunteers, and employees committed to our work of social assistance and social justice. We are accountable to the people in our community who are marginalised by structures of exclusion and injustice.

On 17 December 2012, the government released a consultation paper on draft governance standards for charities registered with the Australian Charities and Not-for-profits Commission (ACNC) ("the consultation paper"). The Society's member states and National Council have consulted, and the Society welcomes the opportunity to contribute this submission on the consultation paper. The Society has previously provided submissions on related issues.[1]

Introduction

The Society generally supports the standards, and the principle of consistent governance rules for all not-for-profit entities. We also support the use of broad language in the standards, which sets up objects to be achieved while allowing each charity to adhere to the standards in its own way. We believe that the Society is already complying with most of the standards, and will be able to comply with all of the standards in due course.

Before commenting on the particular standards themselves, we perceive three general issues applying across the draft governance standards. First, there are practical and policy-level problems with the fact that the enforcement powers are limited to "federally regulated entities".[2] This is regardless of the fact that *all* entities will be required to comply with the standards,[3] even non-federally regulated entities. The Society sees a risk that the ACNC's powerlessness over non-federally regulated entities could be seen as a weakness, unless the ACNC strongly and positive engages with state-based regulators. We note that the ACNC is aware of this issue.[4]

Second, the Society asks what the purpose of the Object to each standard is. Is it to give the public guidance? Is the Object designed to aid the ACNC Commissioner ("the Commissioner") in determining whether the standard has been contravened? Do the Objects themselves form part of the law? Will they be able to be used by an administrative reviewer, or a Judge, in interpreting the content of the standard? We have found the Objects useful – indeed the Object of Standard 4 is more detailed than the standard itself – and we believe a comment as to the purpose and use of the Objects might be helpful, early on in the standards.

Finally, the consultation paper provides little in the way of detail about the reporting and monitoring of the governance standards. Is the self-assessment process, mentioned only briefly in the paper,[5] the only form of reporting and monitoring that will be necessary? If there are to be further reporting

[1] See, for example, *Submission to the Standing Committee on Economics* (20 July 2012) (at vinnies.org.au/files/Submission%20-%20ACNC%20-%20St%20Vincent%20de%20Paul%20Society%20-%2020%20July%202012.pdf); *Submission to Treasury Review of Not-For-Profit Governance Arrangements*, (January 2012) (at vinnies.org.au/files/NAT/SocialJustice/2012/Submission-to-NFP-Governance-Review.%20final.pdf).
[2] As defined in section 205-15 of the *ACNC Act (Cth)* 2012.
[3] The consultation paper, [2.3.5].
[4] Ibid 9.
[5] Discussed at Ibid [2.3.5].

requirements, then these must be an integral part of the discussion regarding the standards; moreover, the administrative costs of reporting any information must not become burdensome for charities.

The Society looks forward to participating in the ongoing discussion about these standards, and also about the ACNC's regulatory approach,[6] and working with the ACNC to attain and maintain best practice over and above the minimum requirements of these standards.

[6] Consultation open at acnc.gov.au/ACNC/Contact_us/Pub_consult_comment/RegApCon/ACNC/Edu/Consult_RegApp.aspx.

1) Standard 1: Purposes and NFP Nature

Draft governance standard 1: Purposes and NFP nature of a registered entity

45.5 Standard 1—purposes and NFP nature of a registered entity

Object

1) The object of this governance standard is:
   a) to commit a registered entity, its members and its responsible entities to the registered entity's purposes; and
   b) to give the public, including members, donors, employees, volunteers and benefit recipients of the registered entity, confidence that the registered entity is acting to further its purposes.

Standard

2) A registered entity must:
   a) be able to demonstrate, by reference to the governing rules of the entity or by other means, its purposes and its character as a not-for-profit entity; and
   b) make information about its purposes available to the public, including members, donors, employees, volunteers and benefit recipients; and
   c) comply with its purposes and its character as a not-for-profit entity.

Note Information in relation to the purposes of a registered entity would be available to the public if it appears on the Australian Charities and Not-for-profits Register, in an Australian law on www.comlaw.gov.au or www.austlii.edu.au, or is otherwise made available on request.

A. Does draft standard one establish the appropriate principles?

The Society agrees that not-for-profits should have a clear purpose and be able to communicate that to all stakeholders, and the general public.

B. Is the wording of draft governance standard one appropriate?

In subsection 1) b), it is unclear whether the words "of a registered entity" are intended to apply to the "members, donors, employees, volunteers, and benefit recipients", or only to the "benefit recipients". The wording could be changed to clarify this.

This semantic issue is repeated in the Object of draft Standard 3, where the identical subordinate clause, defining "public", appears between brackets instead of commas.

Paragraph 2) b)

The governance standard is designed to "enable members, beneficiaries, employees, donors, volunteers, and the rest of the public to be able to easily identify the purpose **and character** of all registered entities" (emphasis added).[7]

As such, paragraph 2) b) might logically be worded to include a requirement that an entity must make information about its not-for-profit character available, as well as about its purposes. For example, standard 2) b) could read: "make information about its purposes ***and character as a not-for-profit-entity*** available to the public... ".

The Note

It is unclear whether the Note is a general statement of fact about what the availability of information will be, or is a specific direction to registered entities as to how to comply with 2) b). Assuming the latter interpretation, a clearer drafting might be: "Note: ***for the purposes of 2) b),*** information ***about*** the purposes ***and character as a not-for-profit entity*** of a registered entity ***is considered "available to the public"*** if ***the information*** appears on the Australian Charities and Not-for-profits Register, ...".

[7] The consultation paper, 11.

2) Standard 2: Accountability to Members

Draft governance standard 2: Accountability to members

45.10 Standard 2—accountability to members

Object

1) The object of this governance standard is to ensure the accountability and transparency of a registered entity to its members.

Standard

2) 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.

Note 1 The steps that a registered entity may take to ensure it is accountable to its members include holding annual general meetings, providing members with an annual report (including financial information and achievements towards its purpose) and providing for elections for its responsible entities.

Note 2 The steps that a registered entity may take to ensure its members have an adequate opportunity to raise concerns include holding an annual general meeting with a question and answer session and providing an opportunity for members to propose resolutions and to vote upon those resolutions.

A. Does draft standard two establish the appropriate principles?

The Society concurs with the objective of this standard – that not-for-profits be accountable to their members. We are pleased that no mandatory minimum requirements have been inserted into this standard, in line with our previous submission on these standards.[8]

Educating members

Per the consultation paper, one purpose of the standard is to ensure "members are in a position to understand the charity's operations".[9] To that end, we would advocate a third limb of proposed subsection 45.10 (2), to the effect that a registered entity must inform members about the key elements of its governance, operations and the financial status.

[8] *Submission to Treasury Review of Not-For-Profit Governance Arrangements*, (January 2012) (at vinnies.org.au/files/NAT/SocialJustice/2012/Submission-to-NFP-Governance-Review.%20final.pdf), Question 28.
[9] The consultation paper, 12.

Societies without members

This standard "would only apply to registered charities that have members."[10] For a charity without members (such as a charitable trust), presumably this means that accountability is to be governed by the charity's existing legal obligations, and no more.

This demonstrates the fact that the standards will not apply uniformly across the sector; an undesirable outcome. Moreover, this lack of uniformity will create confusion in cases where an entity has characteristics of both a trust and a corporation (as at least one of the Society's state bodies has).

Scope of applicability

The *ACNC Act 2012* (Cth) "turned off" some accountability mechanisms for charities that are corporations, including relating to meetings of members.[11] The "turn off" seems to only relate to companies incorporated under the Commonwealth *Corporations Act 2001* (Cth), in line with the fact that, as mentioned above, the ACNC's enforcement powers do not extend to state-incorporated companies.[12]

However, in relation to accountability to members of incorporated associations, the consultation paper mentions examples of state legislation imposing obligations on state-incorporated entities, in NSW and QLD.[13] It seems that there is no talk of those state-based accountability mechanisms (ie those imposed under state law) being "turned off".[14] The practical consequence of this will be incorporated associations and cooperatives will be under strict state-based legislative requirements, whereas charities under the *Corporations Act* will only be bound by the more liberal governance standard. The Society, which comprises a range of both state-based and federally incorporated entities, would endorse an approach whereby the state-based legislation is also "turned off", such that *all* charities are subject only to Standard 2: this would simplify internal procedures.

We note that the discussion of how the regulation of state-based entities will occur is a key part of the Regulatory Impact Assessment (RIA) recently released by the Council of Australian Governments.[15] For these reasons, the Society would strongly encourage government not to bring these standards into force until the issues raised by the RIA have been settled.

Who is a member?

The accountability standard is applied to "members" of the entity. However, the Society believes more clarification and understanding is needed around who are the "members" of each legal entity.

Within the language of the Society, "members" mean people who are admitted to membership of the Society; "members" to us are not members of the corporate entity. For example, in the case of the Society in New South Wales (a company limited by guarantee), a "Society Member" means each person admitted as a member of the Society in NSW. On the other hand, under the company

[10] Ibid.
[11] Ibid 7.
[12] Ibid 9: defined in *ACNC Act*, section 205-15.
[13] The consultation paper, 13.
[14] Council of Australian Governments, *Regulatory Impact Assessment Of Potential Duplication Of Governance And Reporting Standards For Charities* (January 2013) [34].
[15] Ibid 46-50.

constitution of the New South Wales branch of the Society, only "council members" (members of the state-level decision-making body) are admitted as members of the company.

Some clarification of "member" would be appreciated.

B. Is the wording of draft governance standard two appropriate?

The Notes

Both *Notes* could be clarified by adding words to the effect of "***Some examples of***" at the beginning of each note. For example, "Note 1 ***Some examples of*** the steps that a registered entity may take to ensure it is accountable to its members include ...". Otherwise, we find these Notes helpful.

3) Standard 3: Compliance with Australian laws

Draft governance standard 3: Compliance with Australian laws

45.15 Standard 3—compliance with Australian laws

Object

1) The object of this governance standard is to give the public (including members, donors, employees, volunteers and benefit recipients of a registered entity) trust and confidence that a registered entity is governed in a way that ensures its on-going operations and the safety of its assets, through compliance with Australian laws (including preventing the misuse of its assets).

Standard

2) 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.

Note 1 See section 4AA of the *Crimes Act 1914* for the current value of a penalty unit.

Note 2 While a registered entity must comply with all Australian laws, a serious infringement of an Australian law covered by this standard may allow the Commissioner to exercise his or her enforcement powers under Part 4-2 of the Act, following consideration of the matters mentioned in subsection 35-10 (2) of the Act.

Since draft Standard 3 is more general, and wider in its application, than draft Standard 2, we would argue that it makes logical sense that Standard 3 become Standard 2 – that is, be s 45.10 of the *ACNC Act*.

A. Is the wording of draft governance standard three appropriate?

Before discussing whether this draft standard establishes the appropriate principles, we must make a comment on the wording.

Current draft subsection (2) states that "a registered entity must not engage in conduct, or omit to engage in conduct, that may be dealt with ... as an indictable offence .... or by way of a civil penalty...".

The command to *not engage in conduct that may be dealt with as an indictable offence* makes sense. However, the requirement *not to omit to engage in conduct that may be dealt with as an indictable offence* does not make logical sense. That is effectively requiring charities to *engage* in such conduct.

This could be redrafted by simply exhorting entities not to "engage" in the relevant conduct, and then adding a Note stating that "engage in conduct" means either to do an act, or to omit to do an act.[16]

B. Does draft standard three establish the appropriate principles?

The Society strongly agrees that the not-for-profit sector must comply with Australian laws.

Is the intention to ensure compliance with *all* or *some* laws?

First, if the purpose of the standard is to ensure compliance with Australian laws (as the Object seems to imply), then the standard seems superfluous, in that it is already a requirement of all organisations that they comply with all Australian laws.[17] The standard therefore adds nothing.

Secondly, entities are already required to comply with not just a subset but with *all* Australian laws. The Object of this standard presumably also applies to *all* Australian laws ("to give the public … trust and confidence that a registered entity is governed in a way that ensures its on-going operations and the safety of its assets, through **compliance with Australian laws**" (emphasis added)). Therefore, it seems incongruous that this standard clearly states that the registered entity "must not engage" in only *some* civil and criminal offences. Prohibiting only a subclass of behaviours leaves open a strong implication that the standard intends to allow entities to engage in behaviour outside that subclass, and therefore purports to allow entities to commit summary criminal offences, and civil offences with low penalties. This inference cannot be intended, for obvious reasons, since criminal and civil law will continue to apply to registered entities whether or not this standard were engaged by the lesser gravity of an offence committed.

Although this confusion is mostly resolved by Note 2 to this standard, we believe the *standard itself* should simply read: "2) A registered entity must comply with all Australian laws". This would make the purpose very clear.

The engagement of the Commissioner's powers

More than ensuring compliance with Australian laws generally, the intention of this draft standard may be to create a regulation that can be breached in order to give rise to the Commissioner's regulatory powers.[18]

A requirement to comply with *all* laws (outlined above) would be breached, and therefore engage the Commissioner's power, by *any* breach of the law.[19] However, for policy reasons this is not desired, and a minimum level of seriousness of offence is required before the Commissioner's power to act is

[16] This is the approach in the ACT – see *Criminal Code 2002* (ACT) s 13.
[17] The consultation paper, 14.
[18] This is implied at Ibid 14, where it is stated that "The purpose of this draft standard is therefore to enable the ACNC to take appropriate regulatory action where the breach of the law should not affect entitlement to charitable status, but where the breach should nonetheless result in some regulatory action but not in deregistration of a charity."
[19] For example, the Commissioner's power to issue warnings, engaged if the Commissioner reasonably believes that a registered entity has not complied with a governance standard (*ACNC Act*, para 80-5 (1)(b)).

engaged.[20] Therefore, an exhortation to comply with all laws (as we have proposed above) could simply be followed by a subsection explicitly limiting the Commissioner's power:

3) For the purposes of Part 4-2 of this Act, a contravention of subsection 2) does not include conduct engaged in by a registered entity if that conduct may be dealt with
    a) as a summary offence under an Australian law (unless it may, in these circumstances, be dealt with as an indictable offence); or
    b) by way of a civil penalty of less than 60 penalty units.

We consider this approach would be simpler to comprehend than the current drafting: it makes it clear that *all* laws are to be obeyed, and it makes it clear where the Commissioner can step in.

An alternative standard

The Society believes that the vast majority of breaches of the law should be, and will be, dealt with solely under the relevant law that has been breached, rather than with the regulatory intervention of the Commissioner.

As such, instead of setting a strict minimum severity threshold for the Commissioner's powers under this standard (our proposed subsection (3) above), an alternative approach would engage the Commissioner's powers if the conduct meets a more generic standard, for example the conduct:

- may reasonably call into question the registration of an organisation as a charity under the ACNC framework; or
- may necessitate suspension or removal of (a) responsible entity/ies from a charity.

[20] The consultation paper, 16: "The proposed standard would mean that the ACNC could not take regulatory action for minor breaches.".

4) Standard 4: Management of financial affairs

Draft governance standard 4: Responsible management of financial affairs

45.20 Standard 4—responsible management of financial affairs

Object

1) The object of this governance standard is to ensure that a registered entity manages its resources responsibly, in a way that effectively furthers its purposes and protects its resources from misuse.

Standard

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

A. Does draft Standard 4 establish the appropriate principles?

In line with our previous submission on governance standards, the Society is pleased with this high-level standard, leaving each charity to manage its own affairs in its own way.

As with draft Standard 2, because state-based statutory requirements for state-incorporated entities have not been "turned off",[21] this standard will result in different branches of the Society continuing to be subject to different statutory requirements. In keeping with the purposes of the ACNC, we would ask that consideration be given to "turning off" some of the state-based financial reporting requirements, and simply allowing *all* charities to be subject to the same standard, so that charities comprising entities incorporated in different jurisdictions are able to streamline and synthesise their processes. In this vein, again the Society suggests that the Standards not come into force until the issues of uniformity of regulation between state and federal entities (as raised in the RIA) have been properly settled.

B. Is the wording of draft governance Standard 4 appropriate?

No comment.

[21] Council of Australian Governments, above n 14, [40].

5) Standard 5: suitability of responsible entities

Draft governance standard 5: Suitability of responsible entities

45.25 Standard 5—suitability of responsible entities

Object

1) The object of this governance standard is to maintain, protect and enhance public trust and confidence in the governance and operation of a registered entity.

Standard

2) A registered entity must:

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

Note Other Australian laws may require responsible entities to be replaced, if removed, because a registered entity may need to have a minimum number of responsible entities.

Examples of reasonable steps

Reasonable steps may include obtaining declarations from responsible entities and the searching of public registers.

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).

Note Other Australian laws may place other limitations on who may be the responsible entity of a registered entity, or a particular type of registered entity.

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 the Act; and

   b) the entity has been given notice of its disqualification by the Commissioner; and

   c) the Commissioner reasonably believes that the disqualification is justified having regard to

the objects of the Act.

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.

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

45.150 Register of disqualified responsible entities

1) The Commissioner must maintain a register, to be known as the Disqualified Responsible Entities Register, in which the Commissioner 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 Commissioner;

   c) whether the disqualification remains subject to review, under Part 7-2 of the Act.

2) The Register must be maintained by electronic means.

3) The Register must be made available for public inspection, on a website maintained by the Commissioner.

A. Does draft standard 5 establish the appropriate principles?

First, the Society asks whether charities will be required to establish that all a charity's *current* responsible entities are suitable under the standard, or whether the standard only applies to *incoming* responsible entities. The example on page 20 of the consultation paper talks about checking the Register when looking for a *new* director only. If we are required to undertake checks in relation to all of our current responsible entities, this would add significant red-tape, contrary to the purposes of the ACNC.

Secondly, we believe that subsection 45.25 (6) should allow not only for review of the Commissioner's original decision to disqualify an entity, but also for review where the Commissioner refuses to allow a disqualified individual to be a responsible entity in specific circumstances. For example, the wording could be "An entity that is dissatisfied with a decision of the Commissioner to disqualify the entity under subsection (4) ***or to not allow an individual to be a responsible entity under subsection (5)*** may object to the decision..."

Thirdly, the *Corporations Act* disqualification provisions – sections 206B–F – were not "turned off" by the *ACNC Act*. As such, if a person is currently disqualified under the *Corporations Act* from managing a corporation, then the Commissioner's power to allow a disqualified person from managing a charity (proposed subsection 45.25 (5)) would appear to be ineffectual for that responsible entity, if the entity is a corporation. This is because, even if the Commissioner has the power to allow the person to manage a charity under the *ACNC Act*, this allowance will not undo the disqualification under the *Corporations Act*. The same would apply to the various disqualification provisions that

exist in state-based legislation, which the Commissioner's allowance could not undo in relation to that state.[22]

B. Is the wording of draft governance standard 5 appropriate?

We believe it is very unclear from the section that the basic aim is, as the consultation paper says, to ensure that "people who are disqualified from managing corporations may not manage registered charities".[23] The Society suggests that either this aim be added to the Object of the standard, or that the standard be re-drafted to make it clear that the primary aim of the section is to apply the corporate suitability standard to charities, and/or to grant the Commissioner power to disqualify unsuitable people.

The disqualification regime

Disqualifications under section 206 of the *Corporations Act* are generally not indefinite but last for statutorily-defined lengths of time. As such, paragraph 45.25 (3)(a) of the proposed standard should presumably read "***currently*** disqualified from managing a corporation...". Otherwise, it leaves open the possibility of disqualifying from managing charities anyone who has *ever* been disqualified from managing corporations, even if that disqualification lapsed years earlier.

Subsections (5) and (2)

It is unclear how subsection (5) is intended to interact with subsection (2).

Presumably, the requirement in subparagraph (2) b) ii) – that a registered charity remove an entity that is disqualified under the standard from managing a corporation – no longer applies if the Commissioner has made an allowance under subsection (5). However, this is not clear from the face of the draft standard – it seems as though, if an entity is disqualified per subsection 3), then subsection (2) requires their removal *without exception*. This should be clarified.

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

There are no concerns with the general concept of disqualifying entities, and keeping a register.

Term of disqualification

It seems, under subsection (4) of proposed Standard 5, that the disqualification by the Commissioner is perpetual: the subsection doesn't grant the power to set an end-date. This disqualification is therefore different to the suspension power under Division 100-10(2)(b) of the *ACNC Act*, and also unlike disqualifications under the *Corporations Act*, mentioned above, which set time-limits.

If this is intended to be the case, it is surprising that only a disqualification *in the previous 12 months* relevant for the purposes of suitability under paragraph (3)(b). This seems to mean that a responsible entity will be on the register of disqualified entities forever, but will nevertheless be able to start acting as a responsible entity again after 12 months.

[22] Council of Australian Governments, above n 14, 73.
[23] The consultation paper, 17.

Moreover, the Commissioner doesn't seem to have a power to *un*disqualify responsible entities. The Society believes that the Commissioner shouldn't only have the power to suspend the disqualification in specific circumstances (subsection (5) of the proposed standard), but should be able to go back and undisqualify an entity. This may occur in cases where a mistake is shown, if the entity can demonstrate their current good character, or if a certain amount of time has elapsed. It doesn't seem adequate to us that a perpetual disqualification can only be undone by an objection or appeal under Part 7-2 (which in any case must be lodged within 60 days)[24].

The disqualification regime is not a governance standard

These governance standards are unified by the aim of helping charities to understand what their obligations are. For that reason, the Society believes that regulations creating disqualification powers should be located in a different part of the legislation, as those setting up the register have been (in draft subdivision 45-D), rather than being integrated within the governance standards.

Specifically, subsections (4)–(6), which grant the Commissioner powers, might be better placed within Division 100 of the *ACNC Act*, which grants the powers in relation to suspension and removal of responsible entities. If it is deemed undesirable to place them within the Act, then we would endorse putting these powers within their own Division in the regulations.

[24] *ACNC Act*, subsection 160-10 (1).

6) Standard 6: Duties of responsible entities

Draft governance standard 6: Duties of responsible entities

45.30 Standard 6—duties of responsible entities

Object

1) 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, donors, employees, volunteers and benefit recipients of a 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.

Standard

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 purposes 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.

Note 1 This standard sets out some of the more significant duties of responsible entities. Other duties are imposed by other Australian laws, including the principles and rules of the common law and equity.

Note 2 Some of the duties imposed by other Australian laws may require a responsible entity to

exercise its powers and discharge its duties to a higher standard.

Note 3 For paragraph (2) (e), a perceived or actual material conflict of interest that must be disclosed includes a related party transaction.

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.

Note 1 **Company** is defined in section 205-10 of the Act, to include a body corporate or any unincorporated association or body of persons (but not a partnership).

Note 2 Paragraph (c) applies in situations where paragraph (a) cannot apply, for example, if there is only one director or all the directors have a similar conflict.

Note 3 Part 7-6 of the Act provides for the approval of forms.

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) of the *Corporations Act 2001*.

A. Does draft standard 6 establish the appropriate principles?

The Society agrees with the concept of duties being placed on responsible entities, and is supportive of these duties applying to entities that currently escape the legal regime.[25]

As stated in our previous submission on this issue,[26] we agree with this standard not specifying to whom each of these duties is owed.

A separate question is not who the duties are owed to, but who owes them. The *Corporations Act* duties – which the draft duties in this standard appear to be based on – are *directors' duties*, which fall fairly and squarely on the shoulders of individual directors. The aim of this is to protect stakeholders from directors making poor or selfish decisions. The primary aim of directors' duties is not to make corporations as a whole responsible for the acts of individual directors. For these reasons, the Society

[25] Council of Australian Governments, above n 14, [49].

[26] *Submission to Treasury Review of Not-For-Profit Governance Arrangements*, (January 2012) (at vinnies.org.au/files/NAT/SocialJustice/2012/Submission-to-NFP-Governance-Review.%20final.pdf), response to questions 1 and 2.

believes that practically, semantically, and legally, these duties should continue to fall onto responsible entities themselves.

However, draft standard 6 does not achieve this. Instead, it creates an obligation on the *charity* to ensure that responsible entities are "subject to" the duties. The duties are not directly owed by the person responsible for managing the charity, but instead the charity has an obligation under the standard to ensure that the duties exist. The consultation paper states that this is "consistent with the powers in the ACNC Act".[27]

The Society believes that this approach is conceptually complex, and possibly lacks meaning. It makes little sense for a regulatory requirement to be placed onto registered charities to ensure that their responsible entities have a duty to do something. Moreover, putting obligations onto registered charities to "ensure that" their directors are subject to certain duties is a very different system to the scheme of personal liability for breaches of directors' duties in the *Corporations Act*, which makes *directors themselves* responsible for breaches.

This draft standard seems to be legally and linguistically targeted at regulating the behaviour of charities: on the plain words of the draft standard, the regulation can only be breached by a charity. We cannot see how it could be breached by an individual responsible entity themselves, except in the very specific case of a director's actions leading to the charity not taking reasonable steps to ensure that that or another director were subject to a duty. The Commissioner could then suspend or remove the responsible entity, if and only if this addressed the contravention.[28] In the vast majority of cases of directors breaching the duties, however, the breach of the *standard* itself must be attributed to the charity, and not to the individual.

This means that any breach of a subsection (2) duty by a responsible entity will not give rise to the Commissioner's powers under Part 4-2. Since the *Corporations Act* directors' duties sections have been suspended, there is now no legal standard actually holding responsible entities themselves accountable for breaches of the duties. In the absence of the responsible entity's actions also breaching another section of the *ACNC Act*, then it seems that if an entity breaches a duty listed in subsection 45.30 (2) this will not comprise a breach of the Act and no action will be able to be taken by the regulator.

The Society believes that this is a highly undesirable outcome.

B. Is the wording of draft governance standard 6 appropriate?

A duty within a duty

In addition to the problem of principle, it is highly confusing to speak of a duty within a duty: registered charities have a duty to ensure that responsible entities have a duty. The language (and meaning) should be clarified as follows:

> (2) "a registered entity must take reasonable steps to ensure that its responsible entities are subject to, and comply with, their duties as listed in this standard"

[27] The consultation paper, 23.
[28] *ACNC Act*, subsection 100-10 (1).

(3) for the purposes of subsection (2), the duties that a responsible entity is subject to are as follows: … ”

Reasonable steps

The standard appears to require that charities take “reasonable steps” to ensure compliance with the standards by responsible entities. This is reflected in the Object, which states in subparagraph (1)(b)(ii) that the object is to give confidence that the registered entity – “if non-compliance with the duties imposed on responsible entities occurs – will act to identify and remedy non-compliance”.

However, the standard itself does not specify what action a registered entity may or must take after a responsible entity has not complied with the list of duties. For example, according to the words of the standard, it would seem that, if “reasonable steps” have been taken to ensure that a responsible entity discloses a conflict, then the charity has fulfilled the duty *even if there is a subsequent non-disclosed conflict*. It is unclear to us, from reading the standard, that a breach of the duty by the responsible entity would place an onus on the charity to dismiss the responsible entity or take other action, although this interpretation seems to be implied by the consultation paper.[29]

We think there is room for clarification here, possibly in the form of a further subsection, stating that “if a registered entity reasonably believes that a responsible entity is not subject to, or has not complied with, one of the duties listed in subsection (X) above, then the responsible entity must take reasonable action to ensure that the responsible entity becomes subject to, or complies with, that duty”.

Similarity to the *Corporations Act*

The discussion paper suggests that the draft duties “would be substantially the same as the duties of directors under the Corporations Act 2001”. The same is true of the protections for responsible entities (discussed below).[30]

If this is the case, then we believe it would be helpful to state the intended overlap in the standard. This could be achieved either by referring to the relevant sections in the *Corporations Act*, or by referring to relevant case law in the standard. This would give centuries of case law elucidation to concepts such as “to act in good faith in the best interests of the registered entity”, and give the public, the Commissioner, and, one day, Judges interpreting a standard, help and guidance.

Without this guidance, it appears that the new regulations will be operating in a legal vacuum, without certainty as to how the standards will operate. For directors to function effectively, the legal content of the standards, and their similarity or difference to existing corporate governance standards, must be explicit.

Paragraph (2) (f)

The content of “operating while insolvent” does not replicate the exact words of the section of the *Corporations Act* that it is based on: section 588G if the *Corporations Act* concerns not “operating” but rather “trading while insolvent”. This term, therefore, appears to hold a new and undefined meaning. It is unclear whether “operating” means the same as “trading”, or if it is wider or narrower.

[29] The consultation paper, 26.
[30] Ibid 27.

On the face of it, "operating" seems wider than trading. The Society foresees potential confusion about what activities "operating" is intended to cover.

Subsection (3)

Paragraphs (3) (a) and (b) seem to suggest, on their face, that if the responsible entity is the sole director of a registered entity, or the sole director of a trustee of a trust, then the entity does not need to disclose the conflict at all. The Society is unsure whether this is what was intended.

Paragraph (3) (b) suggests that if the registered entity is a trust, and one of the responsible entities is a director of a trustee, then if the responsible entity tells the other directors *of that trustee* about the conflict, that is enough to satisfy the standard. The Society believes that the trustee should also then be required to alert *any other trustees* of the registered entity of the conflict as well.

If the registered entity is a company, with directors, then we think it is unclear whether the responsible entity chooses whether to alert *either* the other directors (para (3)(a)) *or* the members (para (3)(c)). Note 2 seems to suggest that (c) will come into play where (a) cannot be fulfilled for some reason – but this is not at all clear from the wording of the standard.

C. Protections

Draft protections to standard 6

Subdivision 45-C Protections under governance standard 6

45.100 Reasonable steps taken to ensure compliance with duties

If a responsible entity meets a protection mentioned in this Subdivision, the registered entity is taken to have taken all reasonable steps to ensure that its responsible entities have complied with the duties set out in section 45.30.

45.105 Protection 1

1) A responsible entity meets this protection if the responsible entity, in the exercise of the responsible entity's duties, relies, on information, including professional or expert advice, in good faith, and after the responsible entity has made an independent assessment of the information, if that information has been given by:

    a) an employee of the registered entity that the responsible entity believes on reasonable grounds to be reliable and competent in relation to the matters concerned; or

    b) a professional adviser or expert in relation to matters that the responsible entity believes on reasonable grounds to be within the individual's professional or expert competence; or

    c) another responsible entity in relation to matters within their authority or area of responsibility; or

    d) an authorised committee of responsible entities that does not include the responsible entity.

2) In determining whether the responsible entity has made an independent assessment of the information or advice, regard must be had to the responsible entity's knowledge of the

registered entity and the complexity of the structure and operations of the registered entity.

45.110 Protection 2

1) A responsible entity meets this protection if the responsible entity makes a decision in relation to the registered entity, and the responsible entity meets all of the following:

   a) the responsible entity makes the decision in good faith for a proper purpose; and

   b) the responsible entity does not have a material personal interest in the subject matter of the decision; and

   c) the responsible entity informs itself about the subject matter of the decision, to the extent the entity reasonably believes to be appropriate; and

   d) the responsible entity rationally believes that the decision is in the best interests of the registered entity.

2) In this section:

decision means any decision to take, or not take, action in relation to a matter relevant to the operations of the registered entity.

45.115 Protection 3

1) A responsible entity meets this protection if any of the following are satisfied:

   a) at the time when the debt was incurred, the responsible entity had reasonable grounds to expect, and did expect, that the registered entity was solvent at that time and would remain solvent even if it incurred that debt and any other debts that it incurred at that time; or

   b) the responsible entity took all reasonable steps to prevent the registered entity from incurring the debt.

Note This protection relates to the duty mentioned in paragraph 45.30 (2) (f).

45.120 Protection 4

This section is satisfied if, because of illness or for some other good reason, a responsible entity could not take part in the management of the registered entity at the relevant time.

The Society agrees with the concept of the protections, but sees conceptual problems with the framing.

Subsection 45.30 (4) states that "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)".

Further, section 45.100 states that "If a responsible entity meets a protection mentioned in this Subdivision, the registered entity is taken to have taken all reasonable steps to ensure that its responsible entities have complied with the duties set out in section 45.30."

These two items highlight the problem with a standard which creates a legal duty on charities (registered entities), but where the content of that duty is for the charity to impose another (subsidiary) duty onto directors (responsible entities). The Society thinks it is conceptually very difficult to imagine how the conduct of a *responsible entity* can reasonably be taken to show that the *registered entity* has taken all reasonable steps to ensure compliance. It is perfectly possible that the charity may take no such steps at all, but that the responsible entity still has a defence available to it. Conversely, it is possible that a charity take all possible steps to ensure compliance with the duty, but that the responsible entity nevertheless breaches the duty.

Headings

In our view, each of the protections should have a heading next to it (like the governance standards do). For example, Protection 1 could read: "45.105 Protection 1 – Reliance on information". This would make it clearer what they are about.

Protection 1

In protection 1, subsection (1), there should be no comma after the word "relies" in line 2. In paragraph (c), we believe it would be useful to add the words "***of the registered entity***" after the words "responsible entity", to clarify that it only applies to advice coming from another responsible entity within the same charity (if this is what is intended).

Protection 2

Protection 2 is a reiteration of the "business judgment rule" of the *Corporations Act*.[31] Again, we believe that the fact that this section is meant to repeat that section of the *Corporations Act* should be overtly stated, to help not-for-profits, and ultimately the Courts, understand the protection's content.

We also note that the "business judgment rule" defence has been heavily criticised as not offering real protection to decision-makers.[32]

Protection 3

First, we note that it is unusual in legislative drafting to have only one subsection within a section. Normally the section would just be divided into text and paragraphs in a case like this.

Secondly, as stated in the Note to section 45.115, Protection 3 only relates to the insolvent trading duty. It reflects some of the terms of section 588H of the *Corporations Act*. Instead of leaving the reader to realise via a final Note that this protection only applies to one of the duties, the Society's preferred approach would be to follow the terms of subsection 588H(1) of the *Corporations Act*, and put the scope of the protection upfront, in an early subsection of the protection.

Finally, paragraph (1) a) begins "at the time when the debt was incurred". There is no explanation of what this debt is, in the context of the standards. Presumably, it is a debt that comprises "insolvent trading" (or operating), with a definition similar to that in subsection 588G(1) of the *Corporations*

[31] *Corporations Act*, subsection 180(2).
[32] See, for example, Jenifer Varzaly, "Protecting the Authority of Directors: An Empirical Analysis of the Statutory Business Judgment Rule", *Journal of Corporate Law Studies* 12(2) October 2012 , 429-463.

Act. However, unlike the protection in the *Corporations Act* which specifically refers to section 588G, neither the draft standard nor protection explain what this debt is.

Protection 4

Protection 4 is a repetition of a defence that in the *Corporations Act* only applies to insolvent trading.[33] No reason has been provided as to why the defence is extended in this Standard so that it applies to *all* breaches of the duties, as opposed to just insolvent trading.

Also, it is not at all clear what the "relevant time" mentioned is. The Society supposes it may be taken to be the time period in which the responsible entity is not subject to or does not comply with the relevant duty, but we believe this needs clarification.

D. Should volunteers be treated differently?

The Society is cautious about any suggestion providing volunteers with additional protections than those held by non-volunteer responsible entities. Less strict treatment may give rise to complacency amongst volunteers, and also to differing legal requirements on responsible entities who work together in a team, some of whom are volunteers and some of whom are not.

However, this ties into a broader question of whether it makes logical sense to apply the same level of governance standards to responsible entities of charities (whether volunteers or not) as to directors of for-profit companies, when responsible entities of charities generally achieve far less remuneration and social status from their work than do directors or executives of private companies. Moreover, for-profit companies have a direct contract with shareholders to use their position to further shareholders' interests: as stated above, it is far less clear to whom exactly the duties of not-for-profit responsible entities are owed.

[33] *Corporations Act*, subsection 588H(4).

7) Are the transitional arrangements proposed adequate?

The governance standards are to come into effect from 1 July 2013, but the consultation paper states that charities have a further 18 months to make changes to their procedures.[34] If the charity has rules inconsistent with the standards, then it has 4 years to change its governing rules.[35] It is unclear to the Society at what point exactly a charity could be considered in breach of the standards. For example, if a charity wishes to effect the standards by changes to its governing rules, is it in breach after 1 July 2013, after the point during the 18 months subsequent to that when it changes its rules, or at the end of the 18 months?

Depending on the answers to the above questions, the Society reiterates the view expressed in our previous submission to the review of not-for-profit governance: that the introduction of the regulatory regime may be too soon. This is particularly true given the complex interrelationship between state and federal requirements outlined above, and the fact that the outcomes of the RIA are not yet known, in addition to the fact that the ACNC has not as yet released comprehensive guidelines on how to comply with the standards (and presumably will not be able to do so until the standards are finalised).

Since most charities already meet the standards,[36] there is all the more reason to advance carefully, to give ample time for the standards to be tidied up, and then for the sector to be informed and educated on compliance, especially given the outstanding issue of state and territory co-operation.

The Society recommends that the start-date of the standards be pushed back by at least 6 months, and that the 18-month/4-year deadlines be clarified as discussed above.

[34] The consultation paper, 29.
[35] Ibid 29.
[36] Ibid 10.