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House of Representatives Standing Committee on Economics
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Dear Standing Committee on Economics

House of Representatives Standing Committee on Economics - Inquiry into the Exposure Draft of the Australian Charities and Not-for-profits Commission Bill 2012 and the Associated Transitional and Consequential Amendments Bill 2012

The Australian Institute of Company Directors (Company Directors) welcomes the opportunity to offer comment to the House of Representatives Standing Committee on Economics (the Committee) on the above-mentioned Bills, released on 6 July 2012.

In this submission we reiterate our in-principle support for reform of the current fragmented and duplicative regulatory frameworks applicable to charities and other not-for-profits (NFPs). However, we have a number of concerns in relation to the Exposure Draft of the Australian Charities and Not-for-profits Commission Bill 2012 (“the Bill”), including:

- the process that has been followed for public consultation on the Bill has been inadequate;
- the Bill lacks detail about the proposed interaction between the Australian Charities and Not-for-profits Commission (the ACNC), the Corporations Act and other legislation, and about governance and external conduct standards, which we consider make it impossible to provide meaningful comment on the Bill as a whole;

- some of the current policy settings that appear to underlie key aspects of the Bill are at odds with the stated objectives of the reforms – in particular an apparent starting point (which we do not accept) by drafters of the Bill that there is disregard by charities and their directors (“charity directors”) of their responsibilities at law;
- the requirements in the Bill which pierce the corporate veil by imposing all of the obligations of the primary entity on directors are flawed;
- certain aspects of the liability and offence provisions require further consideration;
- proposing to set governance and external conduct standards through the use of a regulation making power is inappropriate; and
- key parts of the Bill are confusing and overly complex and need to be redrafted.

We strongly urge the Committee to recommend that the introduction of the Bill to Parliament be deferred until the changes called for in this submission are made, and further and more substantive public consultation has taken place. We are of the view that this is the only way to help ensure that the proposed reforms meet the needs of the sector and can be easily understood and applied by those working in the sector.

We recognise that our proposed approach would mean that the establishment of the ACNC needs to be deferred until some later date. While this is unfortunate, it is necessary given that progression of the Bill in its current form would represent a major retrograde step by:

- imposing substantial and unwarranted compliance costs on charities - given the extent and complexity of the proposed requirements in the Bill and also remembering that (absent changes to other legislation governing charities) these requirements are only adding to existing ones;

- making it harder for charities to attract or retain experienced directors (most of whom serve on a pro-bono basis) due to the heavy-handed approach taken in respect of director responsibilities; and
- causing the attention and resources of charities to be taken away from underlying missions which are vital to the less fortunate in our society.

As a nation, we should be encouraging people to “give back to the community” and we should look for ways to support those who volunteer their time for charitable purposes rather than deter them.

1. About Company Directors

Company Directors is the second largest member-based director association worldwide, with over 31,000 individual members from a wide range of corporations: publicly-listed companies, private companies, NFPs, and government and semi-government bodies. As the principal professional body representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current director issues in policy debates.

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

As such, Company Directors has a significant interest in the national NFP reforms currently being progressed. Our Director Social Impact Study 2011 suggests that over half of our members currently hold at least one NFP directorship, in addition to other members who are or have been directly involved in the governance of one or more NFP entities.¹

¹ Company Directors, *Directors Social Impact Study 2011*, at page 5.

2. We support NFP reform, but to progress the Bill in its current form would be a major retrograde step

Company Directors continues to offer its support for measures that help to foster activities undertaken in the NFP sector, including the concept of a single NFP regulator and an information portal that allows ready access to key information about NFPs. We believe, as do many other participants in the sector, that reform (in particular, streamlining existing requirements and reducing duplication) is long overdue and should be a Government priority.

We have previously submitted the need for policy makers to exercise caution in the development of the regulatory framework for charities, including by not taking a “too heavy-handed” approach.² In doing so, we have stressed the importance of the NFP sector to the economy and society, and the need to arrive at a framework that, amongst other things, does not unduly impede the ability of NFPs to carry out their activities. We have also supported measures to remove unnecessary red tape, regulatory overlap and duplication.

In our submission dated 27 January 2012 to Federal Treasury³, we expressed concerns regarding an earlier and incomplete version of the Bill (released on 9 December 2011), including the observation that many of the proposed requirements were unduly onerous and would add to existing red tape. We note there were some changes made in response to the concerns voiced by us and others, and a deferred separate consideration of several key topics (governance and external conduct standards and reporting requirements). However, we feel strongly that more needs to be done.

We believe that progressing the Bill in its current form has the potential to dramatically weaken an important part of Australia’s social fabric. It is clear that some of the measures contained in the Bill (together with the overall compliance burden the Bill presents) will hurt rather than foster the activities of charities. An

² For example, see our submission to Federal Treasury dated 18 January 2011 which set out our views on the “Scoping Study for a National Not-for-Profit Regulator”. This submission is included in the policy section of our website at <http://www.companydirectors.com.au/Director-Resource-Centre/Policy-on-director-issues/Policy-Submissions>.

³ This submission is included in the policy section of our website at <http://www.companydirectors.com.au/Director-Resource-Centre/Policy-on-director-issues/Policy-Submissions>.

example is the proposed requirements relating to directors of charities (in particular Part 7.4, Division 180 – dealing with obligations, liabilities and offences), many of whom serve on a pro-bono or negligible fee basis and are also donors to the charities they serve. The feedback we have obtained during our discussions with directors of charities on the requirements in the Bill has included that many provisions are “unwarranted”, “harsh”, “unfair”, “unsubstantiated” and “poorly drafted”. We set out our specific concerns with some of these requirements later in this submission.

3. We remain deeply concerned with the process that has been followed for public consultation on the Bill

We have some fundamental difficulties with the way in which the current NFP reform process has been undertaken. Much of the consultation by policy makers (with the notable exception of the consultation efforts of the ACNC Implementation Task Force⁴) has been inadequate. In particular:

- the consultation undertaken has been too short, poorly timed and conducted in a piecemeal way;
- a large part of the consultation has occurred on a restricted and confidential basis;
- the sector has not been presented with a full and proper regulatory impact assessment of the proposed changes (including in the event that agreement cannot be reached with the various State Governments as regards removal of overlapping and conflicting state-based requirements); and
- key aspects of the Bill have not had the benefit of any public consultation (see below).

In our previous submissions, we have also outlined our concerns regarding the way in which the NFP reform process has been undertaken⁵. In particular, we have noted that consultation on the first draft Bill and its related materials occurred over the

⁴ Submission by Company Directors dated 27 February 2012 to the ACNC Implementation Task Force on the Discussion Paper “Australian Charities and Not-for-profits Commission: Implementation Design”. This submission is included in the policy section of our website at <http://www.companydirectors.com.au/Director-Resource-Centre/Policy-on-director-issues/Policy-Submissions>.

⁵ Refer to Company Directors’ submission 27 January 2012 dated to Federal Treasury in response to the Draft Charities and Not-for-profits Commission Bill 2012. This submission is included in the policy section of our website at <http://www.companydirectors.com.au/Director-Resource-Centre/Policy-on-director-issues/Policy-Submissions>.

Christmas/January period, and sufficient time was not provided to comment. We also expressed concern about the fragmented approach to NFP consultation, and noted that a more holistic approach was required. We were not alone in expressing such views, as submissions lodged by other organisations show.⁶

We note that no additional public consultation was conducted by Treasury on the Bill currently before the Committee, which surprises and disappoints us given the large potential impact of the matters being considered and that this is counter to commonly accepted principles of good regulatory reform. While we welcome the consultation by the Committee, the current two week consultation period provided is too short, and does not give us a proper opportunity to address the concerns we have about the impact of the proposed requirements. A two week period provides an insufficient opportunity to give feedback on the entirety of the Bill.

Unfortunately we are left with the impression that attempts are being made to push requirements through, even where current proposals are inappropriate, incomplete and unlikely to have the broad support of the NFP/charities sector. Public consultation appears to be seen by policy makers as an unnecessary “burden” or something that could “interfere” with intended reforms, rather than an integral part of an effective reform process that will aid in getting the policy settings and proposals right.

We note that concerns were expressed by many in the NFP sector regarding the proposed reporting and governance requirements, which have now resulted in the deletion and deferral of various aspects of the Bill until further consultation can be undertaken. We believe there is a similar need to have full and proper public consultation around the proposed director liability provisions and the reform package in its entirety. As set out below, until the proposed legislation relating to the reform of the charities framework is considered as a whole, no part of the legislation should be passed.

These reforms are critical to Australia’s most vulnerable citizens so it is important that the regulation imposed is appropriate, workable and accurate. We are eager to

⁶ For example, submissions lodged by the Institute of Chartered Accountants in Australia and Chartered Secretaries Australia.

avoid the need for consequential amendments to be made in the future to remedy issues that could be avoided now, as this will impose further costs on the sector.

4. We are concerned that the interaction between the ACNC, the Corporations Act and other legislation has not been addressed

Currently charities registered with ASIC as public companies limited by guarantee are regulated pursuant to the provisions set out in the Corporations Act 2001 (C'th). However, neither the Bill nor the Explanatory Memorandum provide any detail as to how the Government intends for the requirements under the Bill to interact with the Corporations Act. The following questions arise:

- Are the requirements under the Bill, intended to be *in addition* to the requirements for public companies limited by guarantee under the Corporations Act?
- If the requirements under the Bill are *in addition* to the requirements in the Corporations Act, what will occur where those obligations and responsibilities conflict and how does the Bill reduce red tape?
- If the requirements under the Bill are intended to operate as a *substitute* or to *replace* some or all of the requirements in the Corporations Act, where is the draft legislation that exempts these public companies from the Corporations Act requirements?

As it currently stands and on the basis of the Bill presented, on 1 October 2012, charities registered as public companies limited by guarantee will have to comply with both the ACNC legislation and the Corporations Act. In the same way, incorporated associations will need to comply with both the ACNC legislation and the relevant state Incorporated Associations legislation. If this is correct, the Bill by itself does not in any way contribute to the reduction of red tape within the sector and simply adds an extra layer of compliance to an already stretched sector.

It is difficult to estimate the regulatory and compliance burden of the Bill, particularly given this burden is influenced in large part by what changes are made to existing requirements (e.g. overlapping and conflicting requirements). There is the

potential for this burden to be significant. We note that the Explanatory Memorandum to the Bill states:

“17.112 The costs and benefits associated with this option [Option 2: Pursue the establishment of a national regulatory framework], particularly in relation to regulatory and compliance burden will depend on the final scope of reforms which are agreed with the States and Territories. Given informational gaps which do not allow for accurate quantification of compliance costs, we would not be able to estimate potential reductions in compliance costs resulting from this Option.”⁷

Presenting the Bill, without clarity as to how the competing legal requirements in different Acts will interact, presents a significant roadblock to the achievement of this reform. By not explaining or presenting a complete set of draft legislation which identifies how these competing provisions will interact, it is incredibly difficult for us and other stakeholders to comment upon the merits or otherwise of the Bill. Directors of any company, but particularly charities with limited resources, need to easily and clearly understand the legislative provisions that apply to them.

It is essential that all of the above issues are properly and thoughtfully addressed, and subject to public consultation, before any legislation (including the Bill) is passed in respect of the charities reform. The entire package of legislation should be presented together before any aspects of the reforms are passed.

5. We are extremely concerned that some key policy settings in the Bill are incorrect and are inconsistent with stated objectives

We note that as part of its 2010 election campaign, the Federal Government committed to strengthen the NFP sector, through:

- “a new Office for the NFP Sector supported by a new NFP Sector Reform Council;
- a scoping study for a national ‘one-stop shop’ regulator for the NFP sector, to remove the complex regulatory arrangements currently in place and streamline reporting arrangements;
- greater harmonisation and simplification between Commonwealth, state and territory governments on NFP issues, including regulation; and

⁷ Explanatory Memorandum to the Bill, at page 242.

- reducing red-tape for government funded NFP organisations.”⁸

We consider that the policy settings of, and the requirements included in, the Bill are a far cry from what the Government said it was attempting to achieve. Rather than “removing complex regulations”, “streamlining reporting”, and “harmonising existing requirements”, the Bill includes various requirements relating to charities and those individuals who govern them which go far beyond what exist now, are unwarranted, and will ultimately lead to a much weaker charities sector.

Nor do we consider that the proposed measures in the Bill will meet the stated objects of the Bill outlined in section 15-5, namely:

- “ (a) to maintain, protect and enhance public trust and confidence in the Australian not-for-profit sector; and
- (b) to support and sustain a robust, vibrant, independent and innovative Australian not-for-profit sector.”

As noted elsewhere in this submission, the adverse consequences that the Bill will impose on charities, include:

- the impact of the proposed complex and onerous obligations, including the cost of obtaining legal and other professional advice to decipher the meaning of the provisions;
- the impact that the liability and offence provisions relating to directors will have on the available pool of experienced directors willing to serve on charity boards; and
- the overly risk averse behaviour that these provisions are likely to lead to.

We believe that various aspects of the Bill could be described as “a sledgehammer to crack a nut”. Rather than using as a starting point that those governing organisations are working to serve a charitable purpose, the starting point chosen appears to be that there is disregard by charities and directors of their responsibilities at law and harsh measures need to be adopted.

⁸ Refer to “Final Report - Scoping Study for a National Not-For-Profit Regulator”, April 2011, page 10.

We note that there appears to have been an underlying premise adopted by the drafters of the Bill that poor governance and misconduct is endemic among charities – a premise which we would strenuously challenge. As examples, this premise is reflected in provisions that:

- cause obligations imposed on charities to be imposed equally on their directors (the majority of whom serve on a pro-bono or negligible fee basis)⁹;
- cause liabilities to be imposed on individuals who oversee unincorporated charities, without providing appropriate defences (in circumstances where those individuals are also largely volunteers);
- give the ACNC Commissioner extensive enforcement, revocation, suspension and removal powers;
- impose a “duty to notify” upon charities similar to that required for prudentially regulated entities; and
- create a complex maze of requirements, which will be unintelligible to most individuals they are intended apply to.

We recognise there needs to be a level of public accountability by charities and those individuals which govern them, but we strongly believe it is wrong in principle to adopt a “lowest common denominator” approach when imposing responsibilities on charities and their directors– as it is for most other circumstances. Many of the requirements in the Bill that apply to directors of charities are more onerous than what apply to directors of our largest listed companies. We query why this is desirable or necessary.

We are concerned that volunteers will simply say that it is too difficult to navigate their role as a director of a charity and will walk away, leaving a sector already stretched for resources with less assistance. This is quite aside from the important issue of fairness in how we treat individuals looking to make a contribution to the work of charities and the missions they pursue. As a nation, we should be encouraging people to “give back to the community” and we should look for ways to

⁹ See section 180-5.

support those who volunteer their time for charitable purposes rather than deter them.

We are of the view that there are other ways of promoting accountability which are far more preferable (and without the adverse consequences of the approach currently proposed), including through increased transparency.

6. We believe that the requirements in the Bill that impose all of the obligations of the primary entity on directors are flawed

We note that section 180-5 of the Bill provides as follows:

“Subject to subsection (2), an obligation that is imposed under this Act on an entity (the primary entity) is imposed on each entity that was covered by section 180-15 at the time the obligation arose, but may be discharged by any such entity.”

The effect of this section is that every obligation of a charity under the Bill will become the personal obligation of every person who has a directorial role within the charity. The term “obligation” is not defined.

We note the purpose of imposing upon directors personally, all of the obligations of the charities upon which they hold directorships, is to ensure that those charities which are not separate legal persons (such as unincorporated associations) are bound by the provisions of the Bill. The Explanatory Memorandum provides:

“[13.149 -50] The Bill imposes certain obligations...on specific entities referred to as ‘covered entities’ that are responsible for managing the primary entity. This ensures that covered entities are accountable for fulfilling the obligations contained in the Bill. This is particularly important in the case of entities that do not have legal personality, such as unincorporated associations and trusts, as they cannot be sued or penalised.”

While we understand the basis for trying to ensure that the individuals who run unincorporated associations, for example, are bound by the obligations in the Bill, we have some serious concerns about the ramifications of drafting section 180-5 in this way for corporate entities.

Section 180-5 opens the door to eroding the concept of limited liability and the recognition that a company and its directors are separate legal persons. Assuming that the company is the primary entity, the provision means that every obligation of the company becomes the personal obligation of the director. This drafting fails to recognise that the company and its controllers are distinct and separate legal entities and goes further than any other piece of Australian legislation by imposing *all* of the obligations of the company under the Bill on the directors.

The proposed approach to director obligations is likely to adversely impact the activities charities undertake through shrinking the available pool of experienced directors willing to serve on charity boards (with a resultant impact on the quality of board decisions) and by causing directors to be overly risk averse and compliance-focused in their deliberations (at the cost of performance). This will in turn impact on the contribution that charities make to people's daily lives and broader society. As such, the proposed approach to director responsibilities gives rise to important public policy concerns.

Although the Bill confines the *liability* of directors to specified circumstances, it is misguided if the Government is of the view that the application of the *obligations* provision (section 180-5) to companies (even with confined liability for directors) has little impact or is of no consequence. The Bill imposes a range of obligations on NFP companies to do particular things, such as the duty to notify¹⁰ and to lodge documents. By drafting section 180-5 in this way, it means these obligations (whether or not the liability is confined) become the personal obligations of individual directors. In other words, the directors must carry them out. This approach has the potential to create confusion as it completely severs the line between the corporation's responsibilities and the individual's responsibilities, making good governance practices difficult or impossible.

One of the key benefits of the corporate form is that the company is its own legal person with all the powers of a body corporate and a natural person. The company is operated or run by management and overseen or monitored by its directors. By being

¹⁰ There are obligations on charities to notify the ACNC Commissioner of various matters under section 65(1) including certain contraventions of the Act or non-compliance with a governance standard or external conduct standard. Such obligations would extend to each charity director by virtue of section 180-5(1).

a step away from the “doing” or the “day to day operations” of the company, the directors have a greater opportunity to be impartial and to question and test that the company is being run properly. As soon as directors have the same obligations as the company, the ability of directors to monitor is removed and other longstanding benefits of incorporation are negated.

While we understand that the Government is trying to regulate a diverse range of entities with different legal forms, the consequences of such a provision for fundamental principles of corporate law should not be underestimated. We also put forward that the legislation should clearly delineate between the obligations of charities and the duties of charity directors. We have repeatedly said that we consider that the approach taken in the Corporations Act is generally appropriate – where the starting point is that the organisation is subject to obligations, and the directors owe their duties to the organisation they serve (with an appropriate “business” judgement rule). We recognise that some modification is required for unincorporated associations and trust-based structures.

Any proposal to depart from this approach should be the subject of detailed analysis, wide consultation and public debate. To date this process has not occurred.

We note (as set out below) that the liability which attaches to individuals in unincorporated bodies is potentially much higher than for incorporated bodies. On this basis, it may be that many unincorporated bodies will chose to incorporate, where this is possible. While some may see this “encouragement” to incorporate as a positive step forward, it is contradictory for the Bill on the one hand to encourage incorporation and at the same time entirely pierce the corporate veil on the other.

We strongly urge the Government to reconsider the drafting of section 180-5 and to consider carefully the ramifications that this provision will have for well established principles of corporate law in this country.

7. The liability and offence provisions in the Bill are difficult to read and impose onerous obligations on volunteers of unincorporated bodies

We are concerned that directors and those with directorial type roles in the NFP sector will find Part 7.4 of the Bill particularly difficult to understand. We have set out our concerns regarding the obligations provision (section 180-5) above and now turn to addressing the provisions relating to liabilities and offences.

7.1 Liabilities

We note that the liability under the Bill (which is referred to as “an amount that is payable” under the Bill) is confined for directors of bodies corporate and directors of corporate trustees. On this basis, these directors will only be liable for an amount payable by the primary entity because of the director’s “dishonesty, gross negligence or recklessness”; or because of a “deliberate act or omission” on the part of a director. Subject to comments above about the organisation and its directors having separate and distinct obligations (such as set out in the Corporations Act), our preliminary view is that the standard of “dishonesty, gross negligence or recklessness” is likely to be a workable standard for civil liability. However, we are of the view that the words “deliberate act or omission of the director” should be reconsidered, given that acts or omissions that are honest and entirely appropriate may also be “deliberate.”

It is concerning to us that individuals overseeing unincorporated charities appear to be liable for any and every amount payable by the primary entity under the Bill, without exception. If our understanding of these provisions is accurate, this would mean that those who serve unincorporated bodies will bear all of the new obligations and liabilities of the charity under the Bill without access to defences. In other words the individuals would be liable, even if they acted honestly, were not involved in a contravention and had no knowledge of a contravention. Is it the Government’s intention to impose such onerous responsibilities on people who are trying to serve their communities?

We recommend that the Government make clear in the Bill and in the Explanatory Memorandum which contraventions attract civil or administrative type liabilities and

penalties and which attract criminal sanctions or penalties. These reforms are targeted at a sector that is under-resourced and staffed by many volunteers. There should be no confusion as to the type of liability or penalty that accrues and the circumstances in which it will accrue. These provisions are drafted in a way that makes these concepts unclear.

We are of the view that these provisions may have a significant impact upon those willing to participate in the sector. In an earlier submission, we made comments in respect of director liability that similarly apply to those individuals that take on directorial type roles in unincorporated charities:

“Evidence has been provided elsewhere¹¹ that the burden of legal risk being confronted by Australian directors is leading to an overly cautious approach to decision-making, focussing directors’ minds excessively on risk avoidance rather than on ways to add value, and discouraging talented people from taking up or holding directorships.

The Federal Government should not exacerbate this problem by imposing further personal liability on individual directors for corporate misconduct. The imposition of such provisions would not lead to good social or economic outcomes and NFPs can least afford directors being overly focussed on personal liability issues. While we believe this problem should be addressed in both the for-profit and NFP sectors, we note there are particularly strong arguments and precedent¹² for exempting “volunteers” of community based projects and organisations – including volunteer directors - from personal liability provided, for instance, they act in good faith.”¹³

We would ask the Committee to consider these points and the ramifications that would eventuate should people refuse to volunteer in the sector.

7.2 Offences

We note that the directors of incorporated bodies will only be liable for the company’s offence where that offence relates to the company’s non-compliance with

¹¹ Federal Treasury survey of ASX 200 directors released in late 2008 referred to at <http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1387> and the Australian Institute of Company Directors, *Impact of Legislation on Directors*, November 2010 available at <http://www.companydirectors.com.au/Media/Media+Releases/2010/Liability+laws+damaging+the+economy+director+survey+reveals.htm>.

¹² Various States have introduced legislation which protects volunteers who are carrying out community work from personal liability in certain situations, such as where they act in good faith. See, for example, the Volunteers (Protection from Liability) Act 2002 (Western Australia).

¹³ Refer to Company Directors’ submission dated 18 February 2011 to Federal Treasury in response to the Consultation Paper titled “Scoping study for a national not-for-profit regulator”. This submission is included in the policy section of our website at <http://www.companydirectors.com.au/Director-Resource-Centre/Policy-on-director-issues/Policy-Submissions>.

a direction of the ACNC. Directors of incorporated bodies must prove defences of illness or reasonable steps to avoid liability under these provisions. While this drafting is not consistent with the Company Directors' model provision for the imposition of personal criminal liability on directors for corporate fault (as set out in two of our recent submissions)¹⁴ or accessorial liability, we are pleased to see that the provisions do not impose blanket criminal liability on directors for acts of the company.

Individuals who perform directorial type roles for unincorporated bodies, however, are taken to commit any offence committed by the charity if, for example, they have aided, abetted or been knowingly concerned in the offence. While the accessorial aspects of these provisions are appropriate, there is a concern that the offences for these directorial type positions extend to any offence committed by the primary entity under the Bill.

While the drafting of the offences is not completely incongruent with an appropriate criminal standard, the obligations on the charity, and in turn the director, must be clear. We re-iterate that we are concerned that the drafting of this Part will make it difficult for directors of charities to understand when they will be subject to civil or criminal liability.

8. Key parts of the Bill are confusing and overly complex

We encourage Committee members to read pages 131 to 134 of the Bill (Division 180 – obligations, liabilities and offences), and consider whether in their view the provisions are easily understood. In our view legal professionals, charities and others will have difficulty understanding the requirements set out on these pages.

In general, the terminology used throughout the Bill is likely to create confusion. As examples, the Bill uses the terms: entity, covered entities, federally regulated entity,

¹⁴ Company Directors submissions on the first and second tranche of the Personal Liability for Corporate Fault Reform Bill 2012 (C'th) dated 30 March 2012 and 28 June 2012, available at: <http://www.companydirectors.com.au/Director-Resource-Centre/Policy-on-director-issues/Policy-Submissions/2012/Personal-Liability-for-Corporate-Fault-Reform-Bill-2012> and <http://www.companydirectors.com.au/Director-Resource-Centre/Policy-on-director-issues/Policy-Submissions/2012/Personal-Liability-for-Corporate-Fault-Reform-Bill-second-tranche>.

registered entity, not-for-profit entity, basic religious charity, primary entity, responsible entity, small registered entity, medium registered entity, large registered entity, company and director to identify the obligations and responsibilities of various organisations and individuals under the Bill. We are of the view that the terminology in the Bill should be straightforward and used consistently, so that persons who have directorial type roles in the NFP sector can easily identify and understand their obligations and responsibilities.

We note that the definition of “company” in the Bill is inconsistent with well-established principles of Australian corporate law. The formation of a company requires incorporation and involves a “distinct legal fiction that a new legal person has come into being.”¹⁵ On this basis, including unincorporated associations within the definition of a company (when the association is not incorporated and not a separate legal person) is likely to create confusion within the sector. This is particularly the case when, for example, some NFPs will be registered as companies under the Corporations Act, some will become incorporated associations under State legislation, and others will remain unincorporated associations. It is simply not acceptable to blur these distinctions in the Bill. The law must be clear so that it is entirely plain to those working within the sector, (a) what type of legal structure their organisation has, (b) what the law requires that type of organisation to do and (c) what the law requires them to do as individuals overseeing that organisation. This clarity has not been achieved in the drafting of this Bill.

We also note that the definition of “company” in the Taxation Administration Act 1953 (C’t’h) includes unincorporated associations, however, the Taxation Administration Act does not set out how these types of entities are to be legally created or governed. We are strongly of the view that the legislation designed to set the standards for governing the sector should be consistent in its description of the relevant entities with the legislation that brings these entities into existence (i.e. the Corporations Act, the Incorporated Associations Acts etc). We point out that this is yet another problem of policy makers trying to use the Taxation Administration Act as a template for these reforms.

¹⁵ RP Austin and Ramsay I, *Ford’s Principles of Corporations Law*, Chapter 4 Incorporation and its Consequences.

We understand that one reason for the complexity of the Bill is the different types of organisational forms that can register as charities (companies limited by guarantee, incorporated associations, unincorporated associations, charitable trusts, “bodies of persons”, etc). However, rather than inventing new terms (e.g. responsible entity) or stretching existing ones beyond their usual meaning (e.g. the definitions of “company” and “director” – see section 900-5) in order to address this diversity, we believe a more appropriate approach would be to have various provisions that are markedly different for each of the main organisational forms of charities dealt with in separate chapters of the Bill.

9. Other comments

We have a range of other feedback we could provide on the Bill, but the short consultation period has precluded this. We do however offer the following comments.

9.1 We remain opposed to mandated governance standards

The mandating of governance structures, processes or policies is fraught with difficulties. We have on numerous occasions outlined our concerns with a black letter law approach to corporate governance practices, including:

- it tends to be “one size fits all” and not take into account the diversity of organisational circumstances;
- it encourages a “conformance” mentality and stifles development of alternative practices which could produce better outcomes;
- it is likely to lead to sub-optimal outcomes and may well have unintended consequences; and
- it may result in material “re-tooling” costs for businesses.

Australia is regarded internationally as having a well-developed corporate governance framework and to be at the forefront of good corporate governance education and practices. Our existing governance requirements as they relate to the structures, practices and policies of listed company boards are generally non-prescriptive and disclosure-based. In particular, we note the principles,

recommendations and guidance published by the ASX Corporate Governance Council, with listed companies required to report against the Council's recommendations on an "if not, why not" basis. In addition, there exists further industry guidance.

We believe strongly that such an approach, with an emphasis on disclosure of governance practices and voluntary good practice guidelines, is more likely to result in optimal governance practices being put in place by charities, and should be adopted for the ACNC framework.

9.2 To the extent there are mandated governance and external conduct standards these should not be set using a regulation making power

While consideration of the governance and external conduct aspects of the Bill has been deferred, we note that provision has been made for the imposition of governance and external conduct standards through a regulation making power (see sections 45-10 and 50-10). We recognise that this approach provides some flexibility to adapt standards relatively quickly as circumstances warrant, however we feel strongly, to the extent governance and external conduct standards are mandated, that their introduction should occur through a process of parliamentary discussion, debate and voting. The need for this process is particularly acute given it is proposed that the ACNC Commissioner has the power to suspend or remove a director if a registered charity is a federally regulated entity and the ACNC Commissioner reasonably believes that the entity has not complied, or is likely to not comply, with a governance or external conduct standard (section 100-5(b) and (c)).

9.3 Suspension or removal of a director or other responsible entity should only occur pursuant to a court order

We note it is proposed to give the ACNC Commissioner wide powers to suspend or remove directors of charities (or to direct a director not to make or participate in the making of certain decisions¹⁶). While there are some exceptions (see section 100-5 (2) and (3)), the main circumstances where the ACNC Commissioner can suspend or remove a director include where:

¹⁶ Refer to section 85-10(2) of the Bill.

- (a) the registered entity is a federally regulated entity and the Commissioner reasonably believes that the registered entity has contravened, or is likely to contravene, a provision of this Act; or
- (b) the regulated entity is a federally regulated entity and the Commissioner reasonably believes that the registered entity has not complied, or is likely to not comply, with a governance standard; or
- (c) the Commissioner reasonably believes that the registered entity has not complied, or is likely to not comply, with an external conduct standard.¹⁷

We note that the ACNC Commissioner must consider particular matters set out in the Bill when making a decision relating to the suspension or removal of a director.¹⁸ However, it is concerning that a director can be suspended or removed (or directed not to make or participate in the making of certain decisions) without the registered entity having contravened a provision of the Act (i.e. “likely to contravene” is enough) and that the suspension or removal (or direction) relies on the view of the ACNC (rather than a court) as to a contravention or a likely contravention.

While there is a process of appeal for directors (see Part 7-2), we believe the suspension and removal powers which are proposed for the ACNC Commissioner are unnecessarily draconian. The starting position should be that any suspension or removal of a director can only occur pursuant to a court order on application by the ACNC Commissioner, although we recognise there may be extreme circumstances where suspension or removal of a director might need to occur automatically without a court order (see, for example, section 206B of the Corporations Act). In our view, to do otherwise would undermine long-standing principles of natural justice and would place an unjust and unreasonable burden on the director(s) concerned.

¹⁷ Refer to section 100-5(1) of the Bill.

¹⁸ These matters are (a) the nature, significance and persistence of any contravention of this Act or non-compliance with a governance standard or external conduct standard (or any likely such contravention or non-compliance) by the registered entity;

(b) what action the Commissioner, the registered entity, or any of the responsible entities of the registered entity, could take or have taken:

(i) to address any such contravention or non-compliance (or prevent any likely such contravention or non-compliance); or
(ii) to prevent any similar contravention or non-compliance;

(c) the desirability of ensuring that contributions (see section 205-40) to the registered entity are applied consistently with the not-for-profit nature, and the purpose, of the registered entity;

(d) the objects of any Commonwealth laws that refer to registration under this Act;

(e) the extent (if any) to which the registered entity is conducting its affairs in a way that may cause harm to, or jeopardise, the public trust and confidence in the not-for-profit sector mentioned in subsection 15-5(1) (Objects of this Act);

(f) any other matter that the Commissioner considers relevant. (refer to sections 100-10(6), 100-15 and 35-10(2) of the Bill).

9.4 *We continue to have issues with the thresholds used for defining “small”, “medium” and “large” charities*

Company Directors indicated in its response to the earlier version of the Bill (released in December 2011) that it believes there should have been further public consultation around the appropriateness of the three reporting tiers proposed for charities and their regulatory impact¹⁹. In our view these tier thresholds are too low and it would be much more appropriate, for example, for the upper revenue threshold for a small registered entity to be \$500,000 (as opposed to \$250,000), and the upper revenue threshold for a medium registered entity to be \$2 million (as opposed to \$1 million)²⁰. In addition, these thresholds should be adjusted periodically to take account of inflation. We believe that the reporting thresholds set out in the Bill would impose an unreasonable compliance burden on many charities, the vast majority of which do not have the same compliance resources available to them as “for profit” businesses do.

We trust the comments in our submission are of assistance. Company Directors would be happy to elaborate on any of the points made in this submission should this be required.

Yours sincerely



John H C Colvin
CEO & Managing Director

¹⁹ Refer to Company Directors’ submission 27 January 2012 dated to Federal Treasury in response to the Draft Charities and Not-for-profits Commission Bill 2012. This submission is included in the policy section of our website at <http://www.companydirectors.com.au/Director-Resource-Centre/Policy-on-director-issues/Policy-Submissions>.

²⁰ During Company Directors’ own consultations on this issue a \$5 million reporting tier for large charities (as opposed to \$1 million tier) was strongly advocated by some company directors. We do recognise that this may present some difficulties for policy makers in the short term due to the need to have other agencies, which currently have lower reporting thresholds, accept the proposed charities reporting regime. However, we believe as a longer term goal, this should be pursued.