

Charity Directors' Duties and Liabilities: Steering the Ship Through Murky Waters

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1 INTRODUCTION

- 1.1 Text books are written on the subject matter of this paper. We have attempted to focus on what is relatively new in the context of governors' duties and liabilities.
- 1.2 The paper begins with a significant focus on the new External Conduct Standards (due to become law in July 2019) and the breadth of their application to all charities. It then moves to a broader consideration of governor duties (and the various places the obligations spring from), some protections available for governors, management of conflicts of interest especially in the context of related party transactions and some consequences of breach. Finally we have been asked to comment on recommendations of the ACNC Review Panel in this area and make some observations from the Banking Royal Commission.
- 1.3 The use of the word "governors" (rather than Directors) in this Paper is intentional, as certain duties apply to all governors of charities - whether those governors be directors of a company or management committee members of an association – regardless of the structure of their charity entity.

2 NEW EXTERNAL CONDUCT STANDARDS

- 2.1 In late 2017, the Federal Government announced intended major reforms to the oversight of charities operating overseas. Charities which operate overseas will now be subject to new standards of governance, called the External Conduct Standards.
- 2.2 They will assist Australia in:
 - a Meeting its international obligations under the Financial Action Task Force Recommendations (an inter-governmental body established in 1989 to promote measures for combating money laundering, terrorist financing and related threats to the integrity of the international financial system); and
 - b Meeting its obligations under multiple other international treaties that it is party to.¹
- 2.3 The External Conduct Standards will become operational sometime in July 2019 (if not disallowed) and will operate in addition to the existing ACNC Governance Standards.² The ACNC will start collecting data on charities' compliance with the new External Conduct Standards as part of the 2019-2020 Annual Information Statement (which will be due in the 2020-2021 financial

¹ Explanatory Statement, Australian Charities and Not-for-profits Commission Amendment (2018 Measures No. 2) Regulations 2018, page 1.

² Australian Charities and Not-for-profits Commission, 'External Conduct Standards Regulations set to Begin From July 2019', *Australian Government: Australian Charities and Not-for-profits Commission* (Article, 30 November 2018) <https://www.acnc.gov.au/media/news/external-conduct-standards-regulations-set-begin-july-2019>.



year).³ In practice, the ACNC are already gathering compliance information with new charity registration applications.

- 2.4 While the Standards are obligation of the *registered charity*, governors will need to play a key role in ensuring compliance and are exposed to sanctions if the registered entity does not comply.
- 2.5 Section 50.10 of the *Australian Charities and Not-for-profits Commission Act 2012* (Cth) (the “**ACNC Act**”) provides:

50-10 External conduct standards

(1) *The regulations may specify standards (the **external conduct standards**) with which an entity must comply in order to become registered under this Act, and to remain entitled to be registered under this Act.*

(2) *Without limiting the scope of subsection (1), those standards may:*

(a) *require the entity to ensure that its governing rules provide for a specified matter; or*

(b) *require the entity to achieve specified outcomes and:*

(i) *not specify how the entity is to achieve those outcomes; or*

(ii) *specify principles as to how the entity is to achieve those outcomes; or*

(c) *require the entity to establish and maintain processes for the purpose of ensuring specified matters.*

(2A) *Without limiting subparagraph (2)(b)(ii), the principles mentioned in that subparagraph may reflect the size of the entity, the amount and nature of contributions to the entity and the nature of the activities undertaken by the entity in pursuit of its purposes.*

(3) *However, the external conduct standards must deal only with:*

(a) *matters external to Australia; or*

(b) *matters not external to Australia but that are closely related to, or have or will have a significant impact on, entities, things or matters external to Australia.*

- 2.6 The proposed External Conduct Standards are set out in the *Australian Charities and Not-for-profits Commission Amendment (2018 Measures No. 2) Regulations 2018* (Cth) (the “**Proposed Regulations**”) and will be a new Division 50 of the *Australian Charities and Not-for-profits Commission Regulation 2013* (the “**ACNC Regulations**”).

- 2.7 The External Conduct Standards will set minimum standards for governance, conduct and behavior of registered charities when operating outside of Australia or partnering with others who are operating outside of Australia. They require that those charities put governance processes in place which will have the effect of mitigating key risks.

- 2.8 Notably, the External Conduct Standards will also apply to basic religious charities (“**BRCs**”) – which is different to the ACNC Governance Standards which do not apply to BRCs.

- 2.9 The aim of the introduction of the External Conduct Standards is to ensure that Australian charity resources are not being applied to terrorism, exploitation of vulnerable individuals, or other illegitimate purposes⁴. The outline in the Proposed Regulations states:

“[They] are intended to provide greater confidence that funds sent, and services provided, outside Australia are reaching legitimate beneficiaries and

³ Australian Government, ‘External Conduct Standards FAQs’, *Australian Government: The Treasury* (Article) <https://static.treasury.gov.au/uploads/sites/1/2018/08/FAQs-t317739-1.pdf> at page 2.

⁴ *Ibid.*

*are being used for legitimate purposes. The standards are also intended to prevent a registered entity from being misused by a criminal organisation.*⁵

- 2.10 An entity is responsible for assessing its own compliance with the External Conduct Standards. It must comply with the Standards in order to **become registered**, and **stay registered**, as a charity with the ACNC⁶.
- 2.11 As usual, the ACNC's approach to enforcing the External Conduct Standards and dealing with breaches will be to educate charities on their obligations and support them in compliance. Ultimately their ordinary enforcement powers will also be available to the ACNC - at its highest being de-registration of charities - for non-compliance.⁷

⁵ Australian Charities and Not-for-profits Commission Amendment (2018 Measures No. 2) Regulations 2018, s 2.

⁶ Explanatory Statement, Australian Charities and Not-for-profits Commission Amendment (2018 Measures No. 2) Regulations 2018, page 6.

⁷ Australian Government, 'External Conduct Standards FAQs', *Australian Government: The Treasury* (Article) <https://static.treasury.gov.au/uploads/sites/1/2018/08/FAQs-t317739-1.pdf> at page 4.

2.12 Application of the External Conduct Standards – operating outside Australia

2.12.1 The External Conduct Standards are intended to apply to charities “operating outside Australia”.

2.12.2 Each of the four External Conduct Standards has this provision:

Application

(2) *This standard applies to a registered entity that is:*

- (a) *operating outside Australia; or*
- (b) *working with third parties that are operating outside Australia.*

2.12.3 Proposed Regulation 50.4 then provides:

50.4 Application—operating outside Australia

- (1) *For the purposes of this Division, a registered entity, or a third party, **operates outside Australia** if it operates outside Australia in whole or in part.*
- (2) *However, a registered entity **does not operate outside Australia only because** it carries out activities outside Australia (including providing funds to be used outside Australia) that are directly related to the pursuit of the registered entity’s purposes in Australia and merely incidental to its operations in Australia.*

2.12.4 **Operates:** Is not defined and so takes its ordinary meaning⁸, but providing of funds alone is intended to be caught.

2.12.5 **Outside Australia:**

a **Incidental Inclusion**

i **Caught – any purpose delivery outside Australia** (including activity in Australia directly related to purpose delivery outside Australia). Minor or incidental operation (purpose delivery) outside Australia, by delivery or funding of front line charitable services outside Australia, is enough – Regulation 50.4(1) of the ACNC Regulations states “*operates outside Australia in whole or in part.*” No requirement of amount, and so any amount is sufficient.

ii The EM:

The external conduct standards are intended to apply to registered entities in relation to matters outside Australia and matters that are not outside Australia, but that are closely related to entities, things or matters that are outside Australia. For example, the management of overseas aid within Australia is closely related to matters outside Australia if the registered charity either operates or collaborates with a third party outside Australia.⁹

See Example 4 below [highlighted].

b **Incidental Exclusion**

i **Not caught – incidental outside Australia activity related to purpose delivery in Australia** – Regulation 50.4 of the ACNC Regulations. Even if

⁸ Explanatory Statement, Australian Charities and Not-for-profits Commission Amendment (2018 Measures No. 2) Regulations 2018, page 3.

⁹ Ibid.

the activity is for front line charitable services in Australia, if it is more than incidental, it's caught.

ii The EM:

... [A] registered entity does not operate outside Australia only because it carries out activities outside Australia that are directly related to the pursuit of the entity's purposes in Australia and merely incidental to its operations in Australia. [Schedule 1, item 2, subsection 50.4(2) of the ACNC Regulation 2013]

To qualify for the incidental exemption, the activities must be 'directly related' to the pursuit of the registered entity's purposes in Australia—that is, a matter with a connection to Australia, such as where the registered entity has Australian beneficiaries. If the activities are pursued for purposes outside Australia (that is, to benefit people or purposes outside Australia) the exemption cannot be relied on. [Schedule 1, item 2, subsection 50.4(2) of the ACNC Regulation 2013]

Similarly, even if the activities are directly related to the registered entity's purposes in Australia but are more than incidental when those activities are compared to the entity's operations in Australia, the entity cannot rely on the exemption. The term incidental is used in relation to the activities of the entity, rather than its purposes, so it is necessary to consider both the size and nature of the activities carried on overseas relative to the size and nature of the entity's operations in Australia in forming a qualitative assessment of whether the activities are 'incidental'. The term 'incidental' has its ordinary meaning, and means something minor in conjunction with or ancillary to something else. [Schedule 1, item 2, subsection 50.4(2) of the ACNC Regulation 2013]

Example 1— Directly related to purposes and incidental to operations in Australia

A registered entity is set up in Australia to help Australians suffering from cancer. Part of the treatment it provides can involve travel to Canada. The activities are directly related to the pursuit of the entity's purposes in Australia. They are also incidental when compared to the entity's operations in Australia because of the number of people who travel to Canada, and the fact that the treatment is ancillary to other treatments services offered in Australia. As a result, the entity would not have any obligations under the standards.

Example 2—Directly related to purposes and incidental to operations in Australia

A registered entity is set up in Australia to help homeless Australians. The entity acquires supplies, such as blankets, from overseas providers who are third parties of the registered entity. The activities are directly related to the registered entity's purposes in Australia. The activities are also incidental when compared to the entity's operations in Australia because purchase of blankets under the arrangement is incidental to helping homeless Australians, in the sense that it is a factor used in that service.

Example 3—Directly related to purposes and incidental to operations in Australia

A registered entity that is a school arranges for students to go on a trip overseas to its sister school in Canada. The school's overseas activities are directly related to the pursuit of their purpose in Australia, namely,

educating Australian children. The activities are also incidental when compared with the entity's operations in Australia of providing education services, and the entity would not have any obligations under the standards.

Example 4—Not directly related but incidental to operations in Australia

A registered entity which is a church asks for collections in Australia for the purpose of sending the funds overseas to contribute to foreign disaster relief. The registered entity gives the small amount of funds raised to an overseas church, which is not a registered entity. Because the amount of money raised is small when compared to the church's overall collections and donations to other organisations and causes in Australia, the incidental element is satisfied. However, because the funds are sent to an overseas church for a foreign purpose, it is not directly related to the pursuit of the registered entity's purposes in Australia. As the activities are not directly related to the pursuit of its purposes in Australia, the entity has obligations under the standards.

2.12.6 Third party:

- a A third party is defined in the Proposed Regulations to mean an entity that the charity collaborates with (whether formally or informally) to advance that charity's charitable purpose, and include entities with which the charity has a membership, association or alliance or with which that charity has an "arrangement".¹⁰
- b A third party doesn't have to be a registered charity. In that case, the charity in question must comply with the External Conduct Standards in its dealings with third parties.
- c However, if the third party is a registered charity, "***the [external conduct] standards do not require the [charity] to comply with the [external conduct] standards to the extent that they are dealing with another registered [charity]. This is because the second registered [charity], if it is operating outside Australia, will have its own obligations under the standards***".¹¹

2.13 What are the External Conduct Standards?

2.13.1 There are 4 of them. In summary they are as follows and then we will consider each in turn.

- a Standard 1 – activities and control of resources (including funds)
- b Standard 2 – annual review of overseas activities and record-keeping
- c Standard 3 – anti-fraud and anti-corruption
- d Standard 4 – protection of vulnerable individuals

2.13.2 Standard 1 – activities and control of resources (including funds)¹²

50.20 Standard 1—Activities and control of resources (including funds)

Object

¹⁰ Explanatory Statement, Australian Charities and Not-for-profits Commission Amendment (2018 Measures No. 2) Regulations 2018, page 4.

¹¹ Ibid.

¹² Australian Charities and Not-for-profits Commission Amendment (2018 Measures No. 2) Regulations 2018.

- (1) *The object of this external conduct standard is to give the public (including members, donors, employees, volunteers and benefit recipients of a registered entity to which the standard applies) confidence that a registered entity is managed in a way that:*
 - (a) *ensures that the registered entity remains solvent; and*
 - (b) *minimises the risks to the registered entity's assets; and*
 - (c) *ensures that the registered entity, and its resources, are furthering the registered entity's purposes; and*
 - (d) *ensures that the registered entity is operating in a way that is consistent with its purpose and character as a not-for-profit entity.*

Application

- (2) *This standard applies to a registered entity that is:*
 - (a) *operating outside Australia; or*
 - (b) *working with third parties that are operating outside Australia.*

Standard

- (3) *The registered entity must:*
 - (a) *take reasonable steps to ensure that its activities outside Australia are carried out in a way that is consistent with its purpose and character as a not-for-profit entity; and*
 - (b) *maintain reasonable internal control procedures to ensure that resources (including funds) are used outside Australia in a way that is consistent with its purpose and character as a not-for-profit entity; and*
 - (c) *take reasonable steps to ensure that the resources (including funds) given to third parties outside Australia (or within Australia for use outside Australia) are applied:*
 - (i) *in accordance with the entity's purpose and character as a not-for-profit entity; and*
 - (ii) *with reasonable controls and risk management processes in place.*

Note: Paragraphs (a) and (b) are intended to ensure that a registered entity has procedures in place to manage the risks associated with its own operations and activities. Paragraph (c) is intended to ensure that reasonable controls are in place with respect to resources given to third parties.

- (4) *The registered entity must comply, in relation to its activities outside Australia, with Australian laws relating to any of the following:*
 - (a) *money laundering;*
 - (b) *the financing of terrorism;*
 - (c) *sexual offences against children;*
 - (d) *slavery and slavery-like conditions;*
 - (e) *trafficking in individuals and debt bondage;*
 - (f) *people smuggling;*

- (g) *international sanctions;*
 - (h) *taxation;*
 - (i) *bribery.*
- (5) *The registered entity must maintain reasonable internal control procedures to ensure compliance with subsection (4).*

a Note that there are both:

- i internal control steps (para (3)(b)); and
- ii third party steps (para (3)(c)),

that the charity needs to be able to demonstrate it is taking.

b What are **reasonable steps**? Objective test based on:

- i The level of risk of funds being misapplied in the destination country;
- ii The size of the charity; and
- iii The value of the resources being applied outside Australia.

c **The EM:**

Because the standards are based around taking 'reasonable steps' or having in place 'reasonable procedures', what is reasonable depends will depend on each entity's particular circumstances. For example, where there is a higher risk of resources given to third parties not being applied in accordance with the entity's purpose and character as a not-for-profit entity, more controls and risk management processes may be needed. If funds are being sent to an area with a high terrorism financing risk, greater controls and risk management processes would be needed to address or mitigate the risks, even if the amounts sent were relatively small. [Schedule 1, item 2, subsection 50.20(3) of the ACNC Regulation 2013]

What is reasonable will depend on the size of the registered entity and the scale of its operations inside and outside Australia and the location and nature of the operations. For larger registered entities or entities with significant resources overseas, having training manuals, staff training programs and staff that ensure compliance and routine audits may be appropriate, whereas this may be beyond what is reasonable for a smaller registered entity if there is less risk of funds being misapplied.

d This Standard also requires compliance (in respect of its activities outside of Australia) with Australian laws relating to money laundering, financing of terrorism, sexual offences against children, slavery and slavery-like conditions, trafficking in individuals and debt bondage, people smuggling, international sanctions, taxation and bribery and it must maintain reasonable internal control procedures to ensure compliance with these things.



2.13.3 Standard 2 – annual review of overseas activities and record-keeping

50.25 Standard 2—Annual review of overseas activities and record-keeping

Object

- (1) *The object of this external conduct standard is to ensure that a registered entity to which the standard applies is transparent and accountable to the public in relation to its activities carried out outside Australia.*

Application

- (2) *This standard applies to a registered entity that is:*
 - (a) *operating outside Australia; or*
 - (b) *working with third parties that are operating outside Australia.*

Standard

- (3) *The registered entity must obtain and keep records necessary to prepare a summary of its activities outside Australia on a country by country basis for each financial year during which it:*
 - (a) *operates outside Australia; or*
 - (b) *gives resources (including funds) to third parties outside Australia (or within Australia for use outside Australia).*

Example: *Records should be obtained and kept about the following information:*

- (a) *the kinds of activities that the registered entity conducted outside Australia;*
 - (b) *details of how the registered entity's activities outside Australia enabled it to pursue and achieve its purpose;*
 - (c) *details of any procedures and processes that the registered entity used to monitor its overseas activities;*
 - (d) *a list of the third parties that the registered entity worked with outside Australia;*
 - (e) *details of any documented claims of inappropriate behaviour by the registered entity's employees or responsible entities outside Australia, and subsequent actions taken by the registered entity as a result.*
- (4) *The records obtained and kept must include information on the registered entity's expenditure relating to its activities outside Australia on a country by country basis for the financial year.*



2.13.4 Standard 3 – anti-fraud and anti-corruption

50.30 Standard 3—Anti-fraud and anti-corruption

Object

(1) *The object of this external conduct standard is to give the public (including members, donors, employees, volunteers and benefit recipients of a registered entity to which the standard applies) confidence that the registered entity is managed in a way that:*

- (a) *ensures that the registered entity remains solvent; and*
- (b) *minimises the risks to the registered entity's assets; and*
- (c) *ensures that the registered entity, and its resources, are furthering the registered entity's purposes; and*
- (d) *ensures that the registered entity is operating in a way that is consistent with its purpose and character as a not-for-profit entity.*

Application

(2) *This standard applies to a registered entity that is:*

- (a) *operating outside Australia; or*
- (b) *working with third parties that are operating outside Australia.*

Standard

(3) *The registered entity must take reasonable steps to:*

- (a) *minimise any risk of corruption, fraud, bribery or other financial impropriety by its responsible entities, employees, volunteers and third parties outside Australia; and*
- (b) *identify and document any perceived or actual material conflicts of interest for their employees, volunteers, third parties and responsible entities outside Australia.*

Note: *A responsible entity of a registered entity must also disclose all material conflicts of interest as one of their duties under governance standard 5—see section 45.25.*

2.14 **Reasonable steps:** takes the same meaning as above.

2.15 **“Minimise risk” does not mean eliminate risk.** Note the difference with the next standard.

(From the EM: The standard requires registered entities to take reasonable steps to minimise risks. An entity need only take reasonable steps, to comply with the standards. The standards do necessarily not require the elimination of any risk, if doing so would be unreasonable or impede the ability of the entity to promote its purposes. What entities are required to do is identify risks of exploitation or abuse and take reasonable actions to mitigate and minimise those risks. Operating a registered entity will involve some level of risk and it would be counterproductive to eliminate all risk.)

2.16 **Extra requirements** (to the Governance Standards) on **conflicts of interest:**

2.16.1 to **identify and document** (not just disclose)

(From the EM: The requirement under these standards to ‘identify and document’ recognises that when operating in certain circumstances overseas, conflicts of interest may be unavoidable where activities are carried out within small communities.



This requires registered entities to at least identify such conflicts, and then report on it as necessary.)

2.16.2 they apply to employees, volunteers and third parties (not just governors).

2.17 Standard 4 – protection of vulnerable individuals

50.35 Standard 4—Protection of vulnerable individuals

Object

- (1) *The object of this external conduct standard is to ensure that when a registered entity to which the standard applies operates outside Australia, it operates in a manner that minimises the risk to vulnerable individuals of exploitation or abuse.*

Application

- (2) *This standard applies to a registered entity that is:*
- (a) *operating outside Australia; or*
 - (b) *working with third parties that are operating outside Australia.*

Standard

- (3) *The registered entity must take reasonable steps to ensure the safety of vulnerable individuals outside Australia to the extent that those individuals are being provided with services, or accessing benefits, under programs provided by:*
- (a) *the registered entity; or*
 - (b) *a third party in collaboration with the registered entity.*
- (4) *The registered entity must take reasonable steps to ensure the safety of vulnerable individuals outside Australia to the extent that those individuals are engaged by:*
- (a) *the registered entity; or*
 - (b) *a third party in collaboration with the registered entity;*
- to provide services or benefits on behalf of the registered entity or the third party.*

2.18 Vulnerable individual is defined (Proposed Regulation 4 of the ACNC Regulations):

vulnerable individual means:

- (a) *a child; or*
- (b) *an individual who is or may be unable to take care of themselves, or is unable to protect themselves against harm or exploitation.*

Example: *An individual may be unable to take care of, or protect, themselves by reason of age, illness, trauma or disability.*

2.19 The language of this standard is not “minimise risk” but “ensure the safety” and therefore while the standard will be tested against what is reasonable in all the circumstances, this is likely to be a higher bar than minimising risk.

The EM:

Because the standard is based on the entity taking ‘reasonable steps’, the steps that are required to be taken will depend on the circumstances. For example, reasonable steps for a larger registered entity may involve having policy documents and specific training for employees and volunteers on how to minimise the risk of abuse to vulnerable individuals. Similarly, larger registered entities may be required to put in place procedures for handling complaints made about employees or volunteers to ensure that individuals in vulnerable circumstances are not put at risk by the employee or volunteer’s presence. However,



reasonable steps for a smaller charity may only involve appropriately investigating and dealing with complaints on an ad hoc basis to ensure that individuals in vulnerable circumstances are protected. [Schedule 1, item 2, subsection 50.35(3) of the ACNC Regulation 2013]

What is reasonable also depends on the risks posed to the vulnerable individuals. Where the risk is greater, more steps may be required to be taken. For example, if there is some risk of abuse to children, it may be necessary to take greater steps to reduce or eliminate that risk. [Schedule 1, item 2, subsection 50.35(3) of the ACNC Regulation 2013]

3 OBLIGATION TO NOTIFY THE ACNC OF SIGNIFICANT BREACHES

- 3.1 A registered charity also has a duty under s 65-5 of the ACNC Act to notify the ACNC Commissioner if:
- 3.1.1 it “has contravened a provision of this Act” or “has not complied with a governance standard or external conduct standard”; and
 - 3.1.2 “the contravention or non-compliance is significant” taking into account:
 - a “the nature, significance and persistence of any contravention or non-compliance”;
 - b “the desirability of ensuring that contributions [to the charity] are applied consistently with the not-for-profit nature, and the purpose, of the registered entity”; and
 - 3.1.3 as a result, the entity is no longer entitled to registration as a charity.
- 3.2 Under s 175-35 of the ACNC Act, an entity is liable to administrative penalty if (emphasis added):
- 3.2.1 the entity is required under the ACNC Act to give a report, return, notice, statement or other document to the Commissioner in the approved form by a particular day; and
 - 3.2.2 the entity does not give the report, return, notice, statement or document to the Commissioner in the approved form by that day.
- 3.3 Of course the “particular day” on which a charity’s contravention or non-compliance becomes significant could be arguable, however it is clear that once a charity is clearly and significantly contravening the requisite Standards, it must notify the ACNC and penalties may apply.
- 3.4 For large charities, the penalty is 5 times the base penalty amount (s 175-40 of the ACNC Act). The “base penalty amount” is 1 penalty for each period of 28 days or part of a period of 28 days:
- 3.4.1 starting on the day when the report, return, notice, statement or other document is due; and
 - 3.4.2 ending when the entity gives it,
- (up to a maximum of 5 penalty units).
- 3.5 That equates to a maximum of 25 penalty units (currently \$5,250) if a large charity fails to notify 113 or more days after the duty to notify the ACNC has been triggered.
- 3.6 Under s 35-10 of the ACNC Act, conditions in which the Commissioner may revoke the registration of a charity include if the Commissioner reasonably believes:



- 3.6.1 “at any time after the date of effect of the registration, the entity is or was not entitled to registration”; or
- 3.6.2 “at any time after the date of effect of the registration:
- a the registered entity has contravened a provision of this Act [including the duty to notify], or it is more likely than not that the registered entity will contravene a provision of this Act; or
 - b the registered entity has not complied with a governance standard or external conduct standard, or it is more likely than not that the registered entity will not comply with such a standard”.

4 ACNC GOVERNANCE STANDARDS (ESPECIALLY GOVERNANCE STANDARD 5) & PROTECTIONS

4.1 ACNC Governance Standards

In addition to the External Conduct Standards covered above, charities must meet the ACNC Governance Standards in order to be registered, and remain registered, as a charity with the ACNC. The ACNC Governance Standards do not apply to Basic Religious Charities.¹³

4.2 Governance Standard 1: Purpose and not-for-profit nature¹⁴

4.3 Governance Standard 2: Accountability to Members¹⁵

4.4 Governance Standard 3: Compliance with Australian laws¹⁶

4.5 Governance Standard 4: Suitability of Responsible Persons¹⁷

4.6 Governance Standard 5: Duties of Responsible Persons¹⁸

4.6.1 This is the Governance Standard which deals with governors’ duties most predominantly, but the compliance obligation is on the charity to take reasonable steps to ensure its governors are subject to and comply the duties (rather than on the governors themselves).

4.6.2 The most recent ACNC Compliance report¹⁹ indicates that almost one-third of its compliance activity in the relevant year was to do with compliance with Governance Standard 5.

¹³ Australian Charities and Not-for-profits Commission, ‘ACNC Governance Standards’ <<https://www.acnc.gov.au/for-charities/manage-your-charity/governance-standards>>.

¹⁴ *Australian Charities and Not-for-profits Commission Regulation 2013* (Cth), Regulation 45.5.

¹⁵ *Ibid* at Regulation 45.10.

¹⁶ *Ibid* at Regulation 45.15.

¹⁷ *Ibid* at Regulation 45.20.

¹⁸ *Australian Charities and Not-for-profits Commission Regulation 2013* (Cth), Regulation 45.25.

¹⁹ <https://www.acnc.gov.au/tools/reports/compliance-report>



4.6.3 This Governance Standard is set out in Regulation 45.25 of the ACNC Regulations:

Governance standard 5--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*
 - (iii) *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 registered entity's best interests, and 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;*

Note: A perceived or actual material conflict of interest that must be disclosed includes a related party transaction.
- (f) *to ensure that the registered entity's financial affairs are managed in a responsible manner;*
- (g) *not to allow the registered entity to operate while insolvent.*

Note 1: Governance standard 5 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](#) (f), ensuring that the registered entity's financial affairs are managed in a responsible manner includes putting in place appropriate and tailored financial systems and procedures.

The systems and procedures for a particular registered entity should be developed having regard to the registered entity's size and circumstances and the complexity of its financial affairs.

The systems and procedures may include:

- (a) procedures relating to spending funds (for example, the approval of expenditure or the signing of cheques); and*
 - (b) having insurance that is appropriate for the registered entity's requirements.*
- (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.

Note 4: A responsible entity may disclose a conflict of interest in the form of a standing notice with ongoing effect.

- (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](#)*

Subdivision 45-C—Protections under governance standard 5

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 45.25.

45.105 Protection 1 [Good faith in reliance on advice]

- (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 [Business judgment – best interests of the charity]

(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;*
- (b) *the responsible entity does not have a material personal interest in the subject matter of the decision;*
- (c) *the responsible entity informs itself about the subject matter of the decision, to the extent the entity reasonably believes to be appropriate;*
- (d) *the responsible entity rationally believes that the decision is in the best interests of the registered entity.*

Note 1: *Protection 2 is also referred to as the "business judgement rule".*

Note 2: *Protection 2 relates to the duty mentioned in paragraph 45.25(2)(a).*

(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 [Reasonable basis for solvency]

A responsible entity meets this protection if:

- (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: *Protection 3 relates to the duty mentioned in paragraph 45.25(2)(g).*

45.120 Protection 4 [Reasonable absence]

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.

- 4.6.4 For most practical purposes, Governance Standard 5 effectively restates the civil directors' duties under the **Corporations Act 2001** (Cth) ("CA")²⁰, to the extent that the charity is an entity registered under the CA. Some requirements of the CA still apply to directors of charities registered under the CA (see the CA section of this Paper below).

²⁰ Australian Charities and Not-for-profits Commission, 'Companies limited by guarantee' <<https://www.acnc.gov.au/for-charities/manage-your-charity/other-regulators/companies-limited-guarantee>>.

5 SOME MURKY WATER TIPS FOR GOVERNANCE STANDARD 5 COMPLIANCE

5.1 What reasonable steps has your charity taken to ensure that governors are subject to and comply with Governance Standard 5?

5.1.1 Appointment letter. The ACNC has a sample.²¹

5.1.2 Board Charter

5.1.3 Constitution – sample clause:

Compliance with ACNC Governance Standards

Without limitation to any other duties or obligations a Director may owe the Company, each Director must at all times, to the extent that it depends upon them, comply with the ACNC Governance Standards and such other regulations or codes of conduct as may be adopted by the Board from time to time.

Then in the definition section:

“ACNC Act” means the Australian Charities and Not-for-profits Commission Act 2012 (Cth) as amended from time to time

“ACNC Governance Standards” means the standards by that name from time to time promulgated as part of the regulations of the ACNC Act

5.1.4 Governance training

5.2 Duty to act with reasonable care and diligence

5.2.1 Governance not operations

5.2.2 Understand the limits of executive authority (limits of delegation to management)²²

5.2.3 Ask questions and follow on questions - necessary to make informed decisions

5.2.4 Be prepared when attending meetings

5.2.5 Use “Business Arising” – matters not fully closed off from the last minutes – questions asked or action directed. Close the loop. Has the question be answered or the action taken?

5.3 Duty to act honestly and fairly in the best interests of the charity and for its charitable purposes

5.3.1 A governors’ first priority must be to the charity. Decisions must be made from the viewpoint of the charity’s best interests, and what would further its charitable purpose.

²¹ <https://www.acnc.gov.au/tools/templates/letter-appointment-responsible-persons>

²² Limitations Policy or Delegations Policy



- 5.3.2 This duty must take priority over any personal interests of the governor, or the interests of any other organisation.²³
- 5.3.3 Ongoing disclosure of:
 - a Business interests
 - b Other governance roles
 - c Employment roles
- 5.3.4 Annual self-evaluation / conversation with the Chair (Deputy Chair) – anything that might be impeding your duty to act in the best interests of the charity alone?
- 5.3.5 See comments below on charity group structures
- 5.4 **Duty not to misuse their position or information they gain as a Responsible Person**
 - 5.4.1 This can cause tension where the Board/Committee member is the appointee of another organisation – these obligations of confidence still apply notwithstanding the appointor’s interest in the subject matter. A governor “*can’t ignore [their] primary obligation to the organisation that [they] have been appointed to, even if [they] think that their ‘appointing organisation’ would benefit from that information. [They] should report back to [their] ‘appointing organisation’ only with authorisation of the committee.*”²⁴
 - 5.4.2 Consider express standing authorisation (ideally in the Constitution) to share information with a Board of sole member charity.
- 5.5 **Duty to ensure that the financial affairs of the charity are managed responsibly**
 - 5.5.1 Reporting against cash flow forecast (not just history)
- 5.6 **Duty not to allow the charity to operate while it is insolvent (able to pay debts as and when they fall due)**
 - 5.6.1 Importantly, governors must be informed about the financial position of the charity.
 - 5.6.2 Solvency checklist if finances get tight. Confirmation that the following have been paid in a timely manner:
 - a Payroll
 - b PAYG
 - c Super
 - d GST
 - 5.6.3 Letter of comfort if finances get tight
 - 5.6.4 Tighter delegations regarding material contracts if things get tight. Board approval required for more contracts than usual. Is there a reasonable basis for the governors

²³ Australian Government, *Running a Charity* (23 May 2017) Australian Charities and Not-for-profits Commission <<https://www.acnc.gov.au/tools/webinars/running-charity>>.

²⁴ Ibid.

to form the view that the charity will be able to perform the obligations under the contract about to be entered into?

5.7 Duty to disclose [and appropriately manage] material conflicts of interest

- 5.7.1 What does your Constitution say – does it need to be amended?
- 5.7.2 Policy & Procedure (follow the procedure as this is about appropriate management of the conflict)
- 5.7.3 Conflicts Register / Minute conflicts disclosure
- 5.7.4 Once a conflict has been disclosed, it needs to be adequately managed. Usually, the conflicted governor should not be present at deliberations or decision-making about the conflict issue. For incorporated associations in some States and Territories there is an additional duty to disclose the conflicts at the next general meeting of the charity.²⁵
- 5.7.5 Below we have expanded on this duty in the context of related party transactions. This area that garnered increasing attention in recent time, especially in the context where it is becoming more common for governors to hold directorships in more than one related entity.

6 CONFLICTS OF INTEREST - FOCUSING ON RELATED PARTY TRANSACTIONS

- 6.1 Regulation 45.25(2)(e) of the ACNC Regulations requires charities to ensure that its responsible persons “disclose perceived or actual material conflicts of interest of the responsible [person]”. A note to that sub-regulation states that:

*A perceived or actual material conflict of interest that must be disclosed is a **related party transaction**.*
- 6.2 Many governors of charities are governors of more than one charity. Often, they are governors of two charities which are related or often have dealings with each other – whether by contracting with one another, or one entity being the subsidiary of another. A common example of this is a Church which “operates” a school as part of its charitable purpose. Often, the Church entity will be the sole member of the school entity (making the school the subsidiary of the Church), and the governors of the Church entity will be the same - or predominantly the same - as the governors of the school entity (the “**Church/School Example**”).
- 6.3 This section of the Paper will address the nature of governors’ duties in such a parent-subsidary relationship where a governor is a governor of **both** entities.
- 6.4 In addition to Governance Standards, the Related Party provisions of the CA (sections 207 and following) also need to be considered (as they have not been turned off by the ACNC legislation). A parent/subsidiary will be related as the parent *controls* (as that term is defined) the subsidiary²⁶. These provisions require member approval (including notification to ASIC) for related party transactions unless an exemption can be relied upon. The exemption that would be relied upon in the context of common boards would usually be section 210 which provides as follows:

²⁵ https://www.nfplaw.org.au/sites/default/files/media/Duties_Guide_CTH_2.pdf 29.

²⁶ Corporations Act 2001 (Cth), s 228.

Arm's length terms

*Member approval [and notification to ASIC] is **not** needed to give a financial benefit on terms that:*

- (a) would be reasonable in the circumstances if the public company or entity and the related party were dealing at arm's length; or*
- (b) are less favourable to the related party than the terms referred to in paragraph (a).*

- 6.5 Government funders (including re-current funders in a School context) may have governance requirements especially impacting related party transactions - that if not complied with, may see a loss of government funding. See for example, *Malek Fahd Islamic School Limited and Minister for Education and Training* [2016] AATA 1087 (23 December 2016).
- 6.6 The definition of "public company" (s9 CA) for the purposes of the related party provisions includes "entities" (broadly defined)²⁷ it controls and:
 - 6.6.1 Includes companies limited by guarantee;
 - 6.6.2 If a company limited by guarantee has been licensed by ASIC to omit limited by its name under s150 of the CA, the related party provisions of the CA do not apply to it but similar duties arise at common law;
 - 6.6.3 State and territory incorporated associations are included.²⁸

²⁷ "entity" : for the purposes of Chapters 2E and 8A an **entity** is any of the following:

- (a) a body corporate;
- (b) a partnership;
- (c) an unincorporated body;
- (d) an individual;
- (e) for a trust that has only 1 trustee--the trustee;
- (f) for a trust that has more than 1 trustee--the trustees together.

Otherwise, **entity** has the meaning given by section 64A. (s9 CA)

²⁸ Due to the definition of "public company" in s9 of the CA which provides as follows: "**public company** " means a company other than a proprietary company and:

- (a) in section 195 and Chapter 2E, includes a body corporate (other than a prescribed body corporate) that:
 - (i) is incorporated in a State or an internal Territory, but not under this Act; and
 - (ii) is included in the official list of a prescribed financial market; and
- (b) in Chapter 2E [Related Party provisions] does not include a company that is not required to have "Limited" in its name because of section 150 or 151.



6.7 **Question 1: Is there a proposed arrangement or understanding between the 2 related parties?**

- 6.7.1 For the definition of “related party” under the CA see s228 of the CA.
- 6.7.2 This could be formal or informal. It is any proposed movement of resources from on “enterprise” to the other.
- 6.7.3 Warning: This includes variations to existing arrangements or understandings.

6.8 **Question 2: How aligned are the charitable purposes of the 2 entities?**

- 6.8.1 In the Church/School Example:
 - a A Church (being the parent) could potentially, as part of its charitable purpose to advance Christian religion depending on how broadly they are drafted, advance Christian education; and
 - b A school usually cannot as part of its charitable purpose of the advancement of education (and in light of the re-current funding limitations), apply its income and assets other than for the purposes of the advancement of education *which does not include the advancement of religion* (or other than for the purposes of the school for which the recurrent funding is provided).

6.9 **Question 3: Are the terms of the proposed arrangement or understanding arms length commercial terms or un-commercial?**

- 6.9.1 Arms length *commercial* benefit **can** flow between related entities.
- 6.9.2 Such commercial benefit is permitted because it is usually conducted by charities in the ordinary course of business and secures goods and services which are needed by the charity to operate (which would be needed regardless of whether those goods or services are provided by another charity or a non-charitable body).
- 6.9.3 Examples of commercial benefit can include:
 - a Payment for secondment of staff at market rates (or less) pursuant to a Secondment Agreement;
 - b Licence fees for use of facilities at market rates (or less) including casual hire (for example in the School/Church Example, the school hiring the Church building for chapel services);
 - c Event Management at market rates (or less) for regular or ad hoc events to be put on by one entity for the benefit of the other (e.g. Chapels) pursuant to an Event Management Agreement;
 - d Surety fee at market rates (or less) for the provision of a guarantee provided by one entity to the other pursuant to a Surety Provision Agreement;
 - e One entity tendering for ancillary services, that may be outsourced by the other (for example in the School/Church Example, the Church running the tuck shop or after school care).
- 6.9.4 Examples of *uncommercial* transactions:



- a a subsidiary operating from land owned by a parent, and paying significantly less than market rent;
 - b the parent entity supplying administrative staff to the subsidiary or providing administrative services, and the subsidiary paying **more than market rates** to the parent for those staff or services.
- 6.9.5 If *commercial*, what is the reasonable evidence of the arms length commercial terms and has this been tabled when governors made decisions?
- 6.9.6 If *uncommercial*:
- a Are charitable purposes aligned?
 - b If no, take advice.
 - c If yes, consider government funding obligations and need to notify ASIC and seek member approval (for an entity registered with ASIC). Take advice if in doubt.
- 6.10 **Question 4: Does Board composition need to be re-considered to help manage the conflicts?**
- 6.10.1 The Board of a subsidiary effectively has unfettered powers in the management of the business of the subsidiary company, which in the extreme could include taking on significant debt or disposing of the subsidiary enterprise (or parts of it) without reference to the parent. There a few different options available in a parent/subsidiary arrangement which could seek to mitigate this risk:
- a **Option 1** – the parent Board being **the same** as the subsidiary Board;
 - b **Option 2** – the subsidiary Board having **a majority** of its members being also members of the parent Board; or
 - c **Option 3** – the subsidiary Board having **some representative directors** from the parent Board, and specifying a number of Reserved Decisions (being major decisions for example change of name, material disposal or encumbrance of assets) which are subject to the prior written consent of the parent entity.
- 6.10.2 However, in an arrangement where a governor is a governor of both a parent and a subsidiary, there arises a *conflict of duty* in that the common governors have duties to act in the best interests of both entities they are governors of. When it is proposed that an arrangement or agreement be struck between those entities, how is this conflict managed?
- 6.10.3 It is commonly thought that the only way of managing a conflict of interest is that the governors who sit on both boards absent themselves from deliberations and decision making any proposed related party transaction between those entities. There is no question that this is one way (and perhaps the most efficient), but especially in the context of a group structure where one entity is the subsidiary of other, it is not the only way (or indeed the best way to prevent mission draft).
- 6.10.4 By way of observation, the law does contemplate and permit directors of wholly owned subsidiary companies taking into account the interests of the parent company under section 187 of the CA, which provides as follows:

Directors of wholly-owned subsidiaries

A director of a corporation that is a wholly-owned subsidiary of a body corporate is taken to act in good faith in the best interests of the subsidiary if:

(a) the constitution of the subsidiary expressly authorises the director to act in the best interests of the holding company; and

(b) the director acts in good faith in the best interests of the holding company; and

(c) the subsidiary is not insolvent at the time the director acts and does not become insolvent because of the director's act.

- 6.10.5 In the Church/School example however, complying with this provision would not be enough to manage a conflict of interest for common directors. This is because of the superseding re-current funding requirements for the school, and the distinct charitable purposes of the Church and College enforced by specific requirements of the ACNC and Commonwealth tax legislation (especially section 50.50(2) of the ITAA 97).
- 6.10.6 It is first important to understand why conflicts of interest need to be managed. In a nut-shell, it is to focus to minds of the governors on their duty to act in the best interests of the entity that at any point in time they are making a decision for (and not in the interests of either themselves or another entity they may also be a governor of). Therefore, when a governor is sitting on the parent board they must act in the best interests of the parent (which may include the subsidiary as the subsidiary is often a vehicle through which the parent pursues its charitable objectives) and when they are sitting on the subsidiary board, they must effectively act in the best interests of the subsidiary only, and only also in the interests of the parent if:
- a the interests of the parent are compatible with the best interests of the subsidiary; and
 - b their independent judgement and discretion is not otherwise fettered.
- 6.10.7 The management of conflicts of interest with a common board is difficult, but in the writers' view is not impossible.
- 6.10.8 For boards that are made up of the same individuals, the conflict cannot be managed by disclosure and the conflicted directors absenting themselves from deliberations and decision making as there would be no governors left to make the decision.
- 6.10.9 A recent paper (December 2017) given at NSW Supreme Court Conference titled, *Conflicts of duties for directors on multiple boards* by Rebecca Maslen-Stannage is instructive²⁹.
- 6.10.10 The following extracts from that paper are particularly instructive:
- a ... *the courts have been quite commercially pragmatic in permitting directors to manage their conflicts of duty across multiple directorships within a fiduciary framework. (p1)*

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http://www.supremecourt.justice.nsw.gov.au/Documents/Publications/Corporate%20and%20Commercial%20Law%20Conference/2017/2017_Maslen-Stannage.pdf.

- b *The courts have, understandably, been unsympathetic to common directors who seek to exploit one company to benefit another and potentially themselves. (p1)*
- c *... comments made by judges in that context **need not cause undue alarm in relation to non-exploitative, arm's length commercial transactions** between companies with common directors. (p2)*
- d *A company is entitled to the unbiased and independent judgement of each of its directors... A director of a company who is also a director of another company may owe conflicting fiduciary duties... Being a fiduciary, the director must not exercise his powers for the benefit or gain of the second company without clearly disclosing the second company's interests to the first company and obtaining the first company's consent... However, the articles of a company [Constitution] may permit – they frequently do permit – a director who is interested in a proposed transaction to take the benefits of the transaction if he discloses his interest to the other members of the board and takes no part in the decision of the board on the transaction... If the director makes that disclosure and abstains from taking part in the decision, the validity of the transaction is not impaired. But a director who takes part in a decision to enter into a transaction in which the director or a third party in whom the director has an interest or to whom the director owes a fiduciary duty stands to gain an advantage or benefit but who does not make an adequate disclosure of his interest acts improperly. (p7, quoting from R v Byrnes [1995] HCA 1)*
- e *As was noted in PBS v Wheeler, informed consent that a director may transact with a company permits arm's length dealing: He came within the rule which absolutely requires a fiduciary to deal with his principal **at arm's length** upon a consent obtained after full disclosure of all relevant facts: Murphy v O'Shea [1845] 2 Jones & Lat 422 per Sugden LC at 425 Consul Development Pty Ltd v DPC Estates Pty Ltd (1975) 132 CLR 373 per Gibbs J at 396; Green & Clara v Bestobell Pty Ltd [1982] WAR 1. (p12)*

6.10.11 It is often required in the Constitutions of subsidiary entities that a requisite number of governors on the subsidiary entity board must be appointed by the parent entity. The Federal Court decision of *State Street Australia Ltd in its capacity as custodian for Retail Employees Superannuation Pty Ltd (Trustee) v Retirement Village Group Management Pty Ltd* [2016] FCA 675 is authority for the proposition that a director of a subsidiary who is appointed by the parent entity can also act in the interests of the parent entity (their appointer) **as long as the interests of the parent are compatible with the best interests of the subsidiary** and their independent judgement and discretion is not otherwise fettered.

6.10.12 The best objective test of “best interests” are arms length commercial terms.

6.11 Question 5: How does a Board determine arms length commercial terms?

6.11.1 The ASIC Regulatory Guide 76³⁰ provides some very useful guidance on the meaning of arm's length in the context of the CA (but is also very instructive about what the term may mean at common law), including:

RG 76.62 The Corporations Act does not define 'arm's length'. Case law on the meaning of 'arm's length' suggests that this phrase refers to a

³⁰ <https://download.asic.gov.au/media/1239851/rg76-published-11-may-2011.pdf>.

relationship between parties where neither bears the other any special duty or obligation, they are unrelated, uninfluenced and each acts in its own interests.

RG 76.64 *Specifically, ASIC v Australian Investors Forum at [456] indicates that, in determining the objective standards that would characterise arm's length terms, courts should consider **the transaction terms that would result if:***

- a ***the parties to the transaction were unrelated in any way (e.g. financially, or through ties of family, affection or dependence);***
- b ***the parties were free from any undue influence, control or pressure;***
- c ***through its relevant decision-makers, each party was sufficiently knowledgeable about the circumstances of the transaction, sufficiently experienced in business and sufficiently well advised to be able to form a sound judgement as to what was in its interests; and***
- d ***each party was concerned only to achieve the best available commercial result for itself in all the circumstances.***

RG 76.70 *At a minimum, public companies ... should take into account all of the following factors when deciding whether ... the arm's length exception in s 210 applies:*

- e *how the terms of the overall transaction compare with those of any comparable transactions between parties dealing on an arm's length basis in similar circumstances (see RG 76.75–RG 76.79);*
- f *the nature and content of the bargaining process, including whether the entity followed robust protocols to ensure that conflicts of interest were appropriately managed in negotiating and structuring the transaction (see RG 76.80–RG 76.85);*
- g *the impact of the transaction on the company ... (e.g. the impact of dealing on those terms on the financial position and performance of the company) and non-associated members (see RG 76.86–RG 76.88);*
- h *any other options that may be available to the entity (see RG 76.89); and*
- i *expert advice received by the entity on the transaction (if any) (see RG 76.90–RG 76.91).*

RG 76.90 *Directors should ensure they have, or have access to, enough knowledge or expertise to assess all aspects of proposed related party transactions—where necessary, they should obtain appropriate professional and expert advice from any appropriately qualified person. This may include the advice referred to in RG 76.74.*

RG 76.91 *The directors will need to be satisfied that it is appropriate to rely on the expert advice, including that the opinion given by the expert is directly relevant to the decision at hand. However, directors relying on information, professional advice or expert advice provided by others must make their own independent assessment of the information or advice: see s189. Advice does not replace careful judgement by the directors.*

6.12 Question 6: How good is conflict of interest Policy & Procedure?

- 6.12.1 For **Common Boards (Option 1 above)**, appropriate management of conflicts of interest require sustained ongoing significant work and would ideally need to be managed by a combination of the following:
- a Drafting (or amendment where the entities are already established) of the Constitutions of each of the parent and subsidiary, to set out in detail **Conflict of interest processes** that will be followed when a conflict arises. These would include:
 - i Requirement for disclosure of conflicts of interest;
 - ii Recording all conflicts in writing in a Conflicts Register;
 - iii Setting out specific steps that must be taken to test that the terms of the proposed arrangement are on arms' length terms; and
 - iv Detailed minutes of the deliberations detailing the reasons why the proposed decision is in the best interests of the entity in question.
 - b There may also need to be some **Committees** established to draw upon a broad range of gifts and skills. Such committees would usually include – Finance; Risk & Compliance; and potentially others.
 - c **Accounting Standard compliance** – Charities that financially report using general purpose (as opposed to special purpose) accounting³¹ must comply with the accounting standards on related party transactions, AASB 124 Related Party Disclosures.³²
- 6.12.2 With a **Majority Board (Option B)** appropriate management of conflicts of interest require sustained ongoing significant work and would ideally need to be managed by a combination of the strategies set out under “Common Boards” above, PLUS an amendment of the subsidiary Constitution to include **Reserved matters** on which the consent of the Parent is required.
- 6.12.3 With a partially **Overlapping Board (Option C)** appropriate management of conflicts of interest may enable a little less rigor on the arms length testing as long as the conflicted directors absent themselves from deliberations' and decisions and the remaining Board members are not acting as a de facto for the parent.

³¹ <https://www.acnc.gov.au/annual-financial-report-general-and-special-purpose-statements>

³² Source: https://www.aasb.gov.au/admin/file/content105/c9/AASB124_12-09_COMPjun14_07-14.pdf and <https://www.acnc.gov.au/for-charities/manage/related-party-transactions>.

7 DIFFERENCE IN DUTIES DEPENDING ON CHARITY STRUCTURE? – NOT REALLY

- 7.1 In our view it is an unproductive moot point to dwell on whether some of the Directors duties under the CA, have been effectively turned off by the ACNC legislation or whether they still all apply to the directors personally. We say unproductive, as even if they have been, in my view there are substantially at least equivalent duties that will arise in every State and Territory:
- 7.1.1 By the charity requiring compliance with the Governance Standards;
 - 7.1.2 By the State and Territory based incorporated association legislation (if that is the type of entity);
 - 7.1.3 At common law and equity.
- 7.2 Directors of entities registered under the CA are subject to Directors' duties in the CA (to the extent that they are not "turned off" – note that trustee companies of charitable trusts are not usually registered as charities in their own right [as it is the trust which holds the charitable registration] and would be subject to the entire range of directors' duties under the CA in respect of their directorship of the company, as well as the obligations imposed on them as a governor of a charity in respect of the trust).
- 7.3 Trustees of charitable trusts (personally or as directors of a trustee company) will have duties under the instrument of Trust and under state based trust legislation.

8 DUTIES UNDER THE CORPORATIONS ACT 2001 (CTH) & ASSOCIATIONS INCORPORATION ACTS

- 8.1 It is well known that a charity which is a company and registered with the ACNC is not required to comply with specific sections under the CA. A comprehensive list of the provisions of the CA that are "turned off" for charity companies can be found in section 111L of the CA.
- 8.2 Among **the provisions that are turned off (should you accept that they are as against the individuals rather than the entity)** are the following sections of the CA:
- 8.2.1 180 (duty to use care and diligence);
 - 8.2.2 181 (duty to act in good faith);
 - 8.2.3 182 (duty not to use position for an improper purpose);
 - 8.2.4 183 (duty not to use information for an improper purpose); and
 - 8.2.5 191 (duty to disclose conflicts of interest).
- Instead, directors are required to comply with the ACNC Governance Standards.
- 8.3 The CA Directors' duties which are **not switched off** are:
- 8.3.1 Chapter 2E (related party transactions); and
 - 8.3.2 Section 588G (duty to prevent insolvent trading).

8.4 Statutory Duty – Chapter 2E CA (related party transactions)

- 8.4.1 This aspect is covered in detail (from the perspective of the Governance Standards) above. However, Directors of companies must still comply with their statutory duties in relation to related party transactions in Chapter 2E of the CA.
- 8.4.2 This Chapter effectively states that there is no prohibition on financial benefits being provided to related parties, provided that the requirements in the Chapter have been complied with.
- 8.4.3 A financial benefit may be provided if:
- a The benefit falls into any of the categories set in sections 210 – 216 of the CA, being:
 - i The parties are dealing at arms length (or more favourable to the organisation);
 - ii It is a remuneration or reimbursement for an officer or employee of the company;
 - iii If the benefit is an indemnity, exemption, insurance premium or payment of legal costs in respect of a liability incurred by an officer of the company in their capacity as such;
 - iv The amount is less than \$5,000³³;
 - v The related party is a closely-held subsidiary;
 - vi The benefit is provided to a member of the company and the benefit does not unfairly discriminate against other members (it is noted that this is a CA section which does not contemplate the not-for-profit limitations imposed upon charities – **this exemption is not available for charities**); or
 - vii The benefit is made under a court order.
 - b For any benefit falling outside of the above exemptions, the company must obtain the approval of the members to provide the benefit, after providing notification to ASIC, and provide the benefit within 15 months of the approval.³⁴

8.5 Statutory Duty – section 588G CA (duty to prevent insolvent trading)

- 8.5.1 This section aims to protect creditors who deal with companies. It goes without saying that if a company is insolvent, there are fewer assets to pay creditors.³⁵
- 8.5.2 The CA lifts the corporate veil by imposing upon directors a duty to prevent insolvent trading if there is reasonable cause to suspect that the company cannot pay its debts in full; it holds them personally liable for company debts incurred while the company is solvent.

³³ *Corporations Regulations 2001* (Cth), Regulation 2E.0.01.

³⁴ *Corporations Act 2001* (Cth), s 208.

³⁵ Paul Latimer, *Australian Business Law* (Oxford University Press, 35th Edition, 2016) 692.



- 8.6 The Incorporated Association legislation in most States and Territories also impose duties on management committee members, which have not been turned off. It is beyond the scope of this paper to consider these. A summary of these can be found in a 2107 article by Ian Ramsay & Miranda Webster, *Registered Charities and Governance Standard 5: An Evaluation* (2017) 45 ABLR 127.

9 SOME COMMON LAW & EQUITABLE GOVERNANCE DUTIES

Common Law

- 9.1 Common law duties (which we note apply to all governors regardless of the structure of the entity) can be grouped into two categories, each of which have sub-categories as follows:
- 9.1.1 Loyalty and good faith
 - a Duty to retain discretions;
 - b Duty to avoid conflicts of interest;
 - c Duty to act in good faith in the interests of the company; and
 - d Duty to use power for a proper purpose.
 - 9.1.2 Care and diligence
 - a Duty to act with reasonable care and diligence.
- 9.2 It is beyond the scope of this paper to discuss differences in duties that may arise by the application of the law of equity and fiduciary obligations.
- 9.3 While many of the statutory duties of directors under the CA are effectively “turned off” for charities and replaced by the ACNC Governance Standards, the duties at common law are not turned off.
- 9.4 Governors’ duties under the ACNC Governance Standards have been discussed above in this Paper. The remaining duties, being those duties not switched off by the ACNC Act and common law duties, are discussed below.
- 9.5 **Common law duty – duty to retain discretions**
- 9.5.1 Governors must be independent and must be free to make decisions for the company.³⁶
- 9.6 **Common law duty – duty to avoid conflicts of interest**
- 9.6.1 Governors must disclose potential conflicts of interest. They must not take private advantage of an opportunity which becomes available to the entity. They are under a fiduciary duty to avoid such undisclosed conflicts of interest.³⁷

³⁶ Paul Latimer, *Australian Business Law* (Oxford University Press, 35th Edition, 2016) 689.

³⁷ *Ibid.*



9.7 Common law duty – duty to act in good faith and in the interests of the entity

9.7.1 Governors owe a duty of loyalty to their entity. They cannot exercise their power for private advantage or for private purpose.³⁸

9.8 Common law duty – duty to use powers for a proper purpose

9.8.1 Governors must use their powers for a proper purpose and not act oppressively.³⁹

9.9 Common law duty – duty to act with reasonable care and diligence

9.9.1 Governors must act with reasonable care and diligence. This requires that they have a requisite level of skill, take a requisite level of reasonable care, and exercise a reasonable level of diligence.

9.9.2 *Duty of skill*

- a A governor 'has a duty greater than that of simply representing a particular field of experience or expertise. A [governor] is not relieved of the duty to pay attention to the [entity]'s affairs which might reasonably be expected to attract enquiry, even outside the area of the [governor's] expertise'.⁴⁰
- b Therefore, governors must take steps to adequately educate themselves to a level of skill which enables them to understand and question the affairs and finances of their entity.

9.9.3 *Duty of reasonable care*

- a Within this duty comes the obligation to be informed, to question and to read accounts. Governors must be financially literate so that they can be sure that the financial statements accurately reflect the entity's financial position.
- b In the Federal Court care of *ASIC v Healy*⁴¹ (also known as the Centro Case), eight Directors breached their financial reporting obligations and their duties of care and diligence when they approved incorrect financial reports. The judgement stated that:

I do consider that all that was required of the directors in this proceeding was the financial literacy to understand basic accounting conventions and proper diligence in reading the financial statements. The directors had the required accumulated knowledge of the affairs of Centro, based upon the documents placed before them and discussion at board meetings. Each director then needed to formulate his own opinion, and apply that opinion to the task of approving the financial statements.

9.9.4 *Duty of diligence*

- a Governors must take reasonable steps to guide and monitor the management of their entity.⁴²

³⁸ Ibid at 690.

³⁹ Ibid.

⁴⁰ *ASIC v Healy* [2011] FCA 717 [18].

⁴¹ [2011] FCA 717 [573].

⁴² Paul Latimer, *Australian Business Law* (Oxford University Press, 35th Edition, 2016) 691.



9.9.5 *Business judgement rule*

- a While the usual statutory business judgement rule in s 180(2) of the CA is switched off and is replaced by protections in the ACNC Regulations, there is also a common law version of the business judgement rule.
- b It recognises that not all decisions made by governors are good decisions, notwithstanding that a governor may have made a decision in good faith. In this event, a governor will not be held automatically liable and will instead be judged under the principles coined in *Donoghue v Stevenson*.⁴³

Equitable duties

- 9.10 The above common law duties are said to be owed both at common law and equity, with loyalty and good faith being fiduciary in nature and duty of care being non-fiduciary.⁴⁴
- 9.11 Justice Young put fiduciary duty in this way in a recent NSW Supreme Court decision - *It should be pointed out that fiduciary duties owed by directors or members of a corporation not aimed at making commercial gain are different from fiduciary duties that exist in the case of an ordinary corporation. With the ordinary corporation formed for gain, it is quite clear that the fiduciary duty will extend not to act in self interest so as to deprive minority members of their property. However, where the corporation is formed otherwise than for gain, that particular aspect of the fiduciary duty may be of minimal importance. There is still a fiduciary duty. This is because the director and sometimes a member in the majority, has an obligation to use his or her power and/or property for the benefit of another. ... Although the incorporated committee will, at law, own the whole of the property and there is no beneficiary as there would be in the case of a trust, the members of the committee will still have a fiduciary obligation to use the property vested in it in its corporate capacity to effectuate the purpose for which the corporation was brought into being. Thus although the property is not held on trust, the members of the committee and the committee as a corporation will have a fiduciary obligation to use the property to effectuate the purpose.*⁴⁵

10 2018 ACNC REVIEW

- 10.1 On 20 December 2017, the review of the ACNC Act was commissioned. Mr Patrick McClure AO was asked to:

*inquire into and make recommendations on appropriate reforms to ensure that the regulatory environment established by the ACNC Act continues to remain contemporary, that the ACNC Acts deliver on their policy objectives and that the ACNC Acts do not impair the work of the ACNC Commissioner to deliver against the objects of the principal Act.*⁴⁶

- 10.2 The Report satisfied the statutory requirement to undertake a review after the first 5 years of the operation of the ACNC Act.

⁴³ Ibid at 692.

⁴⁴ Ford, Austin and Ramsay's *Principles of Corporations Law* (Lexis Nexis Australia, 2016), as cited in Ramsay and Websters' *Registered Charities and Governance Standard 5: An Evaluation* (2017) 45 ABLR 127.

⁴⁵ *Re Theatre Freeholds Ltd* an un reported judgement of the Supreme Court of NSW Equity Division on 12 June 1996.

⁴⁶ Australian Government: The Treasury, *Strengthening for Purpose: Australian Charities and Not-for-profits Commission Legislative Review 2018* <<https://treasury.gov.au/publication/p2018-t318031>>.

- 10.3 The final report was tabled on 2 August 2018. It made 30 recommendations. These recommendations are not set out in this Paper, but can be found in the Executive Summary of the “Strengthening for Purpose: Australian Charities and Not-for-profits Commission Legislation Review – Report and Recommendations”.
- 10.4 We have set out below the recommendations which are relevant to this Paper.

11 REFORMS RECOMMENDED BY 2018 ACNC REVIEW TO SCOPE OF DIRECTORS’ DUTIES

- 11.1 Of relevance to this Paper, the panel recommended that the Commissioner no longer be permitted to replace governors of a charity:

*The Panel considers that the Commissioner’s powers are adequate and do not need to be increased. In relation to federally regulated entities (FREs), the powers of the Commissioner should not be any more than those of regulators overseeing other entities. In this regard, **the Panel recommends the removal of the Commissioner’s powers to replace responsible persons of a registered entity**, and be replaced with the Commissioner only having the powers of comparable regulators.⁴⁷*

- 11.2 The panel also considered the effectiveness of the ACNC Governance Standards and made the following recommendations:

*In respect of the ACNC governance standards, the Panel recommends no changes to Standards 1, 2 and 4. In respect of Standard 3, the Panel recommends that this be repealed. The Panel also recommends that **Standard 5 be retained, but the Regulation be amended to remove the word ‘perceived’ with respect to conflicts of interest.***

*To reduce red tape, the Panel recommends that **a registered entity should be presumed to be in compliance with ACNC governance standards if it already applies a separate set of comparable governance requirements.** The registered entity should be able to self-assess that it is compliant with such governance requirements and make a declaration in the Annual Information Statement (AIS).*

***Director’s duties and other provisions ‘turned off’ under the Corporations Act 2001 (Cth) (Corporations Act) should be ‘turned on’.** This will resolve ambiguity and address other concerns raised in the course of the Review.⁴⁸*

- 11.3 Of course, the “turning on” of the CA provisions would only apply to **entities registered under the CA** and other structure types would be unaffected by this particular reform.

- 11.4 Recommendations were also made to:

⁴⁷ Patrick McClure AO, *Strengthening for Purpose: Australian Charities and Not-for Profits Commission Legislation Review – Report and Recommendations* (31 May 2018) Commonwealth of Australia <<https://treasury.gov.au/sites/default/files/2019-03/p2018-t318031.pdf>>, p 9.

⁴⁸ Patrick McClure AO, *Strengthening for Purpose: Australian Charities and Not-for Profits Commission Legislation Review – Report and Recommendations* (31 May 2018) Commonwealth of Australia <<https://treasury.gov.au/sites/default/files/2019-03/p2018-t318031.pdf>>, p 9.

- 11.4.1 require greater disclosure of related party transactions and remuneration practices, in order to improve public trust and confidence in the sector⁴⁹; and
 - 11.4.2 There is also a recommendation to consider reviewing the exemption of Basic Religious Charities from compliance with the ACNC Governance Standards (provided that other recommendations are adopted)⁵⁰.
- 11.5 The Report has been tabled in Parliament and is awaiting a decision as to whether the recommendations will be implemented.

12 LESSONS FOR CHARITY GOVERNORS FOLLOWING THE BANKING ROYAL COMMISSION

- 12.1 In the aftermath of the Banking Royal Commission Final Report (“**Banking Report**”) released on 9 February 2019, it is more necessary than ever that Boards remain vigilant and educated as to their responsibilities. While the Banking Report directly refers to directors and senior executives in the financial services industry, there are lessons to be taken by all governors about how to avoid similar circumstances in their respective organisations.
- 12.2 In the opening of the Banking Report, the primary responsibility for the misconduct in the financial services industry was placed squarely at the feet of the boards and senior management of the entities in question.⁵¹ The failing that led to the misconduct included **organizational culture, governance and remuneration**.
- 12.3 The Banking Report also points to markers of good governance, including the importance of the board challenging management, and ensuring that there is adequate disclosure of information to the board to enable the board to make informed decisions (and ultimately discharge their duties)⁵².
- 12.4 Peter Warne, the chair of Macquarie Group, has stated that this Banking Report is a warning to governors. “*We need to continue to challenge, to have a much bigger emphasis on compliance and to be 100 per cent sure we are doing the right thing, and not just assuming because we have policies and procedures in place that we are complying with the law,*” says Warne.
- 12.5 ***Governance: Commissioner Hayne emphasized the importance of Board receiving adequate information and challenging management, and used failings by CBA (who did not do enough to ensure that management fixed issues in a timely manner) and NAB (whose board did not receive adequate information and who did not do enough to ensure that management fixed issues when the board became aware of them) as examples. Commissioner Hayne did caution boards, however, against seeing this guidance as a need for the board to become involved in day-to-day management – the task of the board is still governance, not management.***
- 12.6 ***Organisational culture:*** Commissioner Hayne noted that culture cannot be legislated, but is important all the same and needs to be led by the governors. While there is no best practice for creating a desirable culture, Hayne says one necessary aspect is adherence to six basic norms that have now been widely quoted:
- 12.6.1 Obey the law;

⁴⁹ Ibid at p 10.

⁵⁰ Ibid.

⁵¹ Australian Institute of Company Directors, *Key Findings from the Banking Royal Commission Final Report* (1 March 2019) <<https://aicd.companydirectors.com.au/membership/company-director-magazine/2019-back-editions/march/royal-commission>>.

⁵² Ibid.

- 12.6.2 Do not mislead or deceive;
 - 12.6.3 Act fairly;
 - 12.6.4 Provide services that are fit for purpose;
 - 12.6.5 Deliver services with reasonable care and skill; and
 - 12.6.6 When acting for another, act in the best interest of that other.⁵³
- 12.7 *Remuneration*: Remuneration is related to culture, as it communicates to staff what their organisation values – this can either be affirming or demoralizing. In the Banking Report, Hayne stated that “remuneration both affects and reflects culture”. Boards need to consider their level of involvement in remuneration decisions (and the behaviors that they drive) and inject themselves more if necessary.⁵⁴

13 SOME CONSEQUENCES FOLLOWING BREACH OF GOVERNORS DUTIES

13.1 ASIC

- 13.1.1 Breaches by Directors of their duties under the CA (which we note are currently limited for charities) can carry significant sanctions. It is illegal for an organisation to indemnify its Directors for costs and penalties caused as a result of a breach of Directors’ duties.
- 13.1.2 A failure to prevent insolvent trading (s 588G CA – not turned off for charities) can result in:
 - a civil penalties up to \$200,000; and
 - b criminal charges which can lead to a fine of up to \$220,000, imprisonment for up to 5 years or both⁵⁵;
 - c An order to compensate the organisation for damage suffered by it as a result; and
 - d Disqualification.
- 13.1.3 To the extent that Directors are involved in failing to ensure adherence to the related party provisions in Chapter 2E of the CA:
 - a section 209 of the CA states that civil penalties of up to \$200,000⁵⁶;
 - b An order to compensate the organisation for damage suffered by it as a result; and

⁵³ Australian Institute of Company Directors, *Key Findings from the Banking Royal Commission Final Report* (1 March 2019) <<https://aicd.companydirectors.com.au/membership/company-director-magazine/2019-back-editions/march/royal-commission>>.

⁵⁴ Ibid.

⁵⁵ Australian Securities and Investments Commission, *Directors – Consequences of Insolvent Trading* <<https://asic.gov.au/regulatory-resources/insolvency/insolvency-for-directors/directors-consequences-of-insolvent-trading/>>.

⁵⁶ *Corporations Act 2001* (Cth), section 209.

- c If the involvement is dishonest, this may constitute a criminal offence.

13.2 ACNC

13.2.1 The ACNC has power to take action against charities which are not complying with the ACNC Act, Governance Standards or the External Conduct Standards (once law).

13.2.2 It has powers that it can enforce against the charity itself, including:

- a Entering into enforceable undertakings (if federally regulated);
- b Providing directions (if federally regulated); and
- c Revoking charity status.

13.2.3 Revocation of Charity status retrospectively for non-compliance with record keeping obligation is in Part 3-2 of the ACNC Act. See: *Fenn v ABC* [2018] VSC 60 (16 February 2018) and subsequent appeal on pleading issues. However the matters asserted in the following published pleadings in an unreported judgement on the pleadings appeal to the Court of Appeal do not seem to be contested:

7C.1 On 3 December 2012, Ethan was registered as a charity on the charity register of the ACNC.

7C.2 The ACNC is a Commonwealth statutory body operating as Australia's independent national regulator of charities pursuant to the Australian Charities and Not-for-profits Commission Act 2012 ('the ACNC Act') and the Australian Charities and Not-for-profits Commission Regulation 2013 ('the ACNC Regulations').

7C.3 The ACNC Act and the ACNC Regulations prescribe **governance standards** that entities registered with ACNC ('charities') are required to meet ('the ACNC **Governance Standards**').

7C.4 The object of the ACNC **Governance Standards** is to provide a minimum level of confidence that charities will (amongst other things):

7C.4.1 effectively, efficiently and responsibly use the resources available to them;

7C.4.2 meet community expectations about managing their affairs (including the use of public money, volunteer time and donations);

7C.4.3 minimise the risk of mismanagement and misappropriation;

7C.4.4 operate transparently and for a proper purpose; and

7C.4.5 meet their obligations under the ACNC Act and the ACNC Regulations.

7C.5 As part of its regulatory role, the ACNC is:

7C.5.1 responsible for the registration and revocation of charities; and

7C.5.2 required to maintain, protect and enhance public trust and confidence in the not-for-profit and charities sector by ensuring that charities are accountable and transparent.

7C.6 The most serious action the ACNC can take against a charity is to revoke its Commonwealth charitable status. The ACNC will take action and revoke charitable status if it identifies serious mismanagement or misappropriation of funds; a persistent or deliberate breach of the ACNC Act; or that vulnerable people or significant charitable assets are at risk.

7C.7 Charities that have their charitable status revoked lose access to Commonwealth charity tax concessions.

7C.8 The ACNC launched an investigation into the activities and operations of Ethan and assessed Ethan's eligibility for registration as a charity and its compliance with the ACNC **Governance Standards**.

7C.9 The ACNC's investigation revealed that Ethan had failed to comply with its obligations under Part 3–2 of the ACNC Act with respect to record keeping over two consecutive lodgement years.

7C.10 Following its investigation into Ethan, on 25 July 2016, the ACNC revoked Ethan's charitable status and backdated the revocation to 1 July 2013.

7C.11 In an email letter to the ABC on or about 12 December 2016 the Plaintiffs confirmed that they had received a notice from the ACNC setting out the reasons for the revocation of Ethan's charitable status but declined to provide a copy to the ABC.

13.3 It also has powers that it can take against individual governors (of federally regulated charities), being suspension and removal. This may have an impact in for-profit roles held by the governor. For example, failure to comply with the External Conduct Standards can result in consequences for governors. If the Commissioner reasonably believes that a charity (which is not a basic religious charity⁵⁷) hasn't complied with an external standard (or is likely not to comply with an external conduct standard)⁵⁸, the Commissioner may:

13.3.1 Suspend any of the governors (following provision of a show cause notice and a 28 day period for the charity to respond)⁵⁹; or

13.3.2 Remove any of the governors (following provision of a show cause notice and a 28 day period for the charity to respond)⁶⁰ and disqualify them from being eligible to be a governor of another charity⁶¹. The ACNC has not yet disqualified any responsible persons (see: <https://www.acnc.gov.au/charity/about-charity-register/information-charity-register/disqualified-persons-register>).

13.4 Common law / equity

13.4.1 Charity governors who breach their common law / equitable duties can be sued for damages / equitable compensation.

13.5 Commercial and reputational consequences

13.5.1 Potential loss of government funding (e.g. *Malek Fahd Islamic School Limited and Minister for Education and Training* [2016] AATA 1087 (23 December 2016)).

⁵⁷ *Australian Charities and Not-for-profits Commission Act 2012* (Cth), s 100.5(3).

⁵⁸ *Ibid* at s 100.5(1)(c).

⁵⁹ *Ibid* at s 100.10.

⁶⁰ *Ibid* at s 100.15.

⁶¹ *Ibid* at s 100.20(2).

- 13.5.2 Although not involving personal civil or criminal sanctions, the reputational damage that can be done to charities through governor misconduct (or perceived misconduct) can be fatal for charities and can cause irreparable damage to the reputation of the governor in question.
- 13.5.3 Loss of assets to charitable purposes.

14 CONCLUSION

- 14.1 Take homes:
 - 14.1.1 Any money going overseas - whatever type of charity you are – consider the **External Conduct Standards**;
 - 14.1.2 Ask – what are we doing to seek to ensure that our governors comply with the ACNC **Governance Standards** especially Governance Standard 5 (or the like common law obligations)?
 - 14.1.3 Consider and update **Conflict of Interest** policies and procedures – especially when there are related party transactions;
 - 14.1.4 Ask - **is your Board asking questions and following-up?** It is core Board business to:
 - a Insist on adequate information;
 - b Ask questions of management;
 - c If issues are identified by the Board to be fixed by management, insisting on confirmation / evidence that the fix has occurred.

Questions?

Disclaimer: This paper has been prepared for educational purposes and is not intended to be legal advice.