

# **EXPLANATORY STATEMENT**

## **Select Legislative Instrument 2013 No. 23**

### **Issued by authority of the Assistant Treasurer**

Subject - *Australian Charities and Not-for-profits Commission Act 2012*

*Australian Charities and Not-for-profits Commission Amendment  
Regulation 2013 (No. 1)*

As part of its 2011-12 Budget announcements on not-for-profit (NFP) reform, the Government announced the establishment of an independent statutory office, the Australian Charities and Not-for-profits Commission (ACNC). The *Australian Charities and Not-for-profits Commission Act 2012* (the Act) establishes the ACNC as the Commonwealth level regulator for the NFP sector and also establishes a new regulatory framework for the NFP sector.

Section 200-5 of the Act provides that the Governor-General may make regulations, prescribing matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

Subsection 45-10(1) of the Act provides that the Regulations may specify standards (the ***governance standards***) which an entity must comply with in order to become registered under the Act and to remain entitled to be registered under the Act.

The purpose of the Regulation is to amend the *Australian Charities and Not-for-profits Commission Regulation 2013* to specify governance standards which registered entities must comply with in order to become registered under the Act and to remain entitled to be registered under the Act.

The Regulation supports registered entities to fulfil their objectives by providing a minimum level of assurance to the public that they meet community expectations in relation to how a registered entity should be governed and to operate in an effective and transparent manner.

This will support NFP entities in continuing to play a unique role in Australia and operate independently and for the broad public benefit. NFP entities are frequently relied on by many Australians, often by the most vulnerable in our community, so having appropriate governance arrangements and operating in an effective and transparent manner will ensure that the NFP sector remains a robust, vibrant, independent and innovative sector for the benefit of all Australians.

The standards specified in the Regulations are:

- Standard 1 - purposes and not-for-profit nature of a registered entity
- Standard 2 - accountability to members;
- Standard 3 - compliance with Australian laws;
- Standard 4 - suitability of responsible entities; and

- Standard 5 - duties of responsible entities.

Details of the Regulation are set out in Attachment A.

A Statement of Compatibility with Human Rights has been completed for the Regulation, in accordance with the *Human Rights (Parliamentary Scrutiny) Act 2011*. The Statement's assessment is that the measures in the Regulation are compatible with human rights. A copy of the Statement is at Attachment B.

Section 45-15 of the Act specifies that before the power to make the Regulation may be exercised, the Minister must be satisfied that appropriate consultation has been undertaken with the following entities:

- the NFP sector (such as through entities that represent parts of the sector); and
- entities having expertise in fields relevant to the Regulation; and
- entities likely to be affected by the Regulation; and
- the ACNC Commissioner.

Section 45-15 of the Act also specifies that before the power to make the Regulation may be exercised, the Minister must be satisfied that relevant input received as part of that consultation has been taken into account adequately.

The Assistant Treasurer released a draft of the Regulation for public consultation on 17 December 2012 following roundtable consultations with members derived from the NFP Sector Reform Council and other consultative bodies in November 2012. The consultation on the exposure draft Regulation closed on 15 February 2013 and 96 submissions were received from stakeholders in the NFP sector and legal and accounting bodies that advise NFP entities.

In addition to the public consultation on the draft Regulation, the ACNC facilitated a series of face-to-face consultation forums held around Australia (in capital cities and regional centres) in late January — early February 2013. Furthermore, the Office for the Not-for-Profit Sector within the Department of the Prime Minister and Cabinet also administered an online forum on [www.notforprofit.gov.au](http://www.notforprofit.gov.au) to facilitate discussion and provide an additional way for stakeholders to provide comments on the draft Regulation.

Following this extensive process of consultation the Minister is satisfied that the conditions in section 45-15 of the Act have been met and that those listed entities were consulted appropriately and that the input received as part of that consultation was taken into account adequately in the preparation of the Regulation.

The Regulation is a legislative instrument for the purposes of the *Legislative Instruments Act 2003*.

The Regulation commences on the later of the commencement day referred to in section 45-20 of the Act and 1 July 2013.

## **ATTACHMENT A**

### **Details of the Australian Charities and Not-for-profits Commission Amendment Regulation 2013 (No. 1)**

#### **Section 1 – Name of Regulation**

This section provides that the title of the Regulation is the *Australian Charities and Not-for-profits Commission Amendment Regulation 2013 (No. 1)* (the Regulation).

#### **Section 2 – Commencement**

This section provides for the Regulation to commence on the later of the commencement day referred to in section 45-20 of the Act and 1 July 2013.

Section 45-20 of the Act specifies that commencement of the Regulation does not begin until the day after the earlier of either:

- the day both Houses of the Parliament pass a resolution approving the standards; or
- the last day on which the Regulation could be disallowed in either House (which is a 15 sitting day disallowance period) unless the Regulation is disallowed or either House passes a resolution disapproving the Regulation before that day.

#### **Section 3 – Authority**

This section provides that the Regulation is made under the *Australian Charities and Not-for-profits Commission Act 2012*.

#### **Section 4 – Schedule**

This section provides that the amendments in Schedule 1 amend the *Australian Charities and Not-for-profits Commission Regulation 2013* (the Principal Regulation). **Schedule 1 - Amendments of the Australian Charities and Not-for-profits Commission Regulation 2013**

##### ***Item 1 – Section 4 of the Principal Regulation***

This item inserts the definition of **member** into section 4 of the Principal Regulation. The definition relies upon the meaning of ‘member’ in the *Income Tax Assessment Act 1997* and is used throughout the Standards. However, it is most relevant for the purposes of Standard 2.

##### ***Item 2 – Item 1A in table 1 of subsection 40.1(1) of the Principal Regulation***

The insertion of Item 1A into the table in subsection 40.1(1) of the Principal Regulation specifies that information pertaining to the purpose of a registered entity must be included on the ACNC Register where the information includes an extract of the governing rules of the entity and that information has been voluntarily disclosed by the registered entity for the purpose of being included on the Register.

However, the information will only be included on the Register where the Commissioner is satisfied that the extract is consistent with the governing rules of the

registered entity and complies with Standard 1 as set out in section 45.5 of the Regulation (as explained below).

This information will be useful to the public as it will provide a short extract of the registered entity's governing rules which will allow the public to understand the purpose of the entity without having to consider the entirety of the entity's governing rules. It will also provide a useful search term for members of the public using the ACNC Register to find certain sub-types of charities in their community.

### ***Item 3 - Division 45 – Governance standards***

#### **Background to Division 45 – Governance Standards**

'Governance' is the set of practices and procedures in place to ensure that an entity operates to achieve its objectives in an effective and transparent manner.

Governance requirements may be included in:

- existing governing rules, such as constitutions, association rules, cooperative rules, memorandum and articles of association, trust deeds, church laws and statutes;
- contracts that governments enter into with some not-for-profit (NFP) entities; and
- regulatory laws.

The current governance requirements of a NFP entity depend on:

- the type of entity — such as whether it is unincorporated, a trust or a company limited by guarantee, subject to the legislation governing that entity type;
- whether the entity is affiliated with a peak body — such as the Australian Council for International Development, that has a code of conduct for its members; and
- the sector in which the NFP operates — such as the health and education sectors, which have certain governance requirements that must be complied with for an entity to operate in that sector.

NFP entities play a unique role in Australia, operate for the broad public benefit and are frequently relied on by many Australians who are often the most vulnerable in our community. Having appropriate governance arrangements and operating in an effective and transparent manner will ensure that the NFP sector remains a robust, vibrant, independent and innovative sector for the benefit of all Australians.

#### **Subdivision 45-A Preliminary**

## Section 45.1

Section 45.1 sets out an overview of how the Standards apply to entities and will also confirm that the compliance obligations, processes and reasonable steps in the Standards will be interpreted having regard to the objects of the Act and the matters the Commissioner must consider in exercising the Commissioner's powers as listed in section 15-10 of the Act.

### *How the Standards apply and how entities can comply*

The simplified outline explains the steps that a registered entity will need to take to comply with the Standards. The Standards are generally principle-based, specifying the outcome to be achieved, rather than detailing how an entity must meet the Standards, in its particular situation.

The implication of this approach is that steps taken by the registered entity in order to comply with the Standards will vary according to the circumstances of a particular registered entity.

Registered entities cannot choose whether to meet the Standards, but they can choose how they meet the Standards, taking into account their specific situation.

In deciding what processes are reasonable for the entity to implement to satisfy the Standards, the registered entity would consider its size, and the extent to which it receives donations, grants and other monies from governments or the public.

What a large entity must implement to satisfy the requirements will be different from what a small entity must do to satisfy the same requirements.

The larger an entity, and the more public monies it receives, the higher the community expectation that the entity is operating efficiently, effectively and consistent with its stated purposes, and therefore the more the entity can be expected to do to meet that expectation.

Smaller entities are not expected to be less transparent; however, their smaller nature usually means the risk of misuse of funds would be less than for a larger entity.

A smaller entity would usually have a smaller risk of funds being mismanaged or misappropriated, as both the value and the volume of transactions would usually be less, and the members would usually be running the entity. As such, the processes the entity would need to implement to safeguard against mismanagement and to operate openly and transparently would typically be fewer.

In addition, smaller entities will often have more limited resources to develop detailed and prescriptive governance policies.

To further assist registered entities with assessing what steps are necessary, the ACNC Commissioner will release guidance material to assist entities to determine how to comply with the Standards.

### *Interpreting the Standards*

The simplified outline also affirms the link between the Standards and the objects of the Act (as specified in section 45.3 of the Regulation and described below) as well as

the matters the Commissioner must consider in exercising the Commissioner's powers under the Act.

This provides certainty to registered entities that in interpreting the Standards, regard must be had to the objects of the Act and in particular the principles of regulatory necessity, reflecting risk and proportionate regulation as well as the unique nature, independence and diversity of not-for-profit entities and the distinctive role that they play in Australia.

The simplified outline also affirms that the Standards play a role in activating the Commissioner's enforcement powers in Part 4-2 of the Act which will enable the Commissioner to adopt a proportionate regulatory approach and use a wide array of enforcement powers to address minor breaches (for example by using a warning to the registered entity) and major breaches (for example by deregistering the entity).

### Section 45.2

Section 45.2 provides that the Governance Standards in Subdivision 45-B apply for the purposes of section 45-10 of the Act.

### Section 45.3

Section 45.3 affirms the link between the Standards and the objects of the Act by requiring that the Standards be interpreted consistently with the objects of the Act in section 15-5 of the Act, as well as the matters the Commissioner must consider in exercising the Commissioner's powers in section 15-10 of the Act.

The objects of the Act are:

- to maintain, protect and enhance public trust and confidence in the Australian not-for-profit sector;
- to support and sustain a robust, vibrant, independent and innovative Australian not-for-profit sector; and
- to promote the reduction of unnecessary regulatory obligations on the Australian not-for-profit sector.

## **Subdivision 45-B Governance Standards**

### Section 45.5 - Governance Standard 1 – purposes and NFP nature of a registered entity

Section 45.5 provides for Governance Standard 1, under which a registered entity must be able to demonstrate its purposes and its character as an NFP entity, make information about its purposes available to the public, and act in accordance with its purposes and its character as an NFP entity.

For the purposes of this Standard, NFP has the meaning given to it by the common law. There is significant guidance that has been developed by the Australian Taxation Office and the ACNC on the meaning of NFP and also guidance on how entities can practically determine whether they have an NFP purpose and character.

This Standard, covering the purposes and NFP character of the entity, enables members, beneficiaries, employees, donors, volunteers and the rest of the public to be able to easily identify the purpose and character of all registered entities, and commits registered entities, their members and responsible entities, to the purpose and character of the entity. This, in turn, will provide the public with confidence that the registered entity is actively pursuing those stated purposes and acting to prevent any divergence from its purposes and NFP character.

*Demonstrating purposes and character as an NFP entity*

The NFP character of a charity must be demonstrated in its governing rules or by other means.

Registered entities may comply with this by ensuring that their governing rules or other documents set out their purposes. If, for example, the purpose of relieving poverty was stated in the governing rules of a charity that pursued that purpose, this would satisfy the relevant part of this Standard.

Governing rules are those documents of an NFP entity that set out its purposes and how it is to be run. Governing rules may be included in a constitution, association rules, cooperative rules, memoranda and articles of association, legislation, a trust deed or church law. Governing rules cover a broad range of topics, including rules about an entity's mission, procedures for when an entity winds up and removal of members and responsible entities. An entity's governing rules may be drawn from more than one source.

While reference is made to governing rules, the form of the document setting out the NFP character and purposes of the registered entity is not prescribed. Some registered entities may not have conventional constitutions or documentation for their governing rules. However, a registered entity in this situation is able to comply with this Standard by demonstrating its purposes and NFP character through other appropriate means.

*Complying with purposes and character as an NFP entity*

Registered entities would also need to comply with their purposes as an NFP entity. This would be standard practice for registered entities, given they must comply with their NFP purposes and NFP character or risk losing their status as an NFP under existing arrangements and also risk losing concessions or benefits (such as tax concessions) under other laws.

In deciding what steps are necessary to comply with its purpose as an NFP entity, a registered entity should consider not only its size, but also the extent to which it receives donations, grants and other monies from the public (directly or via their governments).

Reasonable steps may include having accounting systems in place to deal with the collection of donations to ensure money is being directed to the purposes of the entity.

For example, a medium registered entity has a process in place to assess the remuneration of its staff against benchmarks from that particular part of the NFP sector. This ensures that the entity is operating as an NFP entity, and is not carried on for the profit or gain of its managers or members through excessive remuneration.

*Making information available about purposes and character as an NFP entity*

The Standard also requires registered entities to make information, in relation to their purposes, available to the public. The Standard does not prescribe how this may be done. Rather, registered entities will be able to choose various ways of making this information available.

For example, for registered entities established by legislation, the legislation setting out their purposes will be a matter of public record, meaning such entities will already be compliant. Further, registered entities may set out their purposes on their websites, or provide the public with the information on request.

The ACNC also maintains the ACNC Register which sets out information in respect of registered entities. As per Item 1 of Schedule 1 to the Regulation, the Commissioner is now required to include on the Register, information pertaining to the purpose of a registered entity where the information includes an extract of the governing rules of the entity, and that information has been voluntarily disclosed by the registered entity for the purpose of being included on the Register.

Where the Commissioner is satisfied that the extract is consistent with the governing rules of the registered entity and complies with Standard 1, having this extract on the Register would be sufficient for the purposes of making information available about purposes and character as an NFP entity.

Section 45.10 - Governance Standard 2 – accountability to members

Section 45.10 provides for Governance Standard 2, under which a registered entity must take reasonable steps to ensure that it is accountable to its members and that members have an adequate opportunity to raise concerns about the governance of the registered entity.

This Standard only applies to registered entities that have *members* (as defined in the *Income Tax Assessment Act 1997*). Examples of entities with members include incorporated associations and companies limited by guarantee. On the other hand, charitable trusts do not have members.

The purpose of this Standard is to ensure registered entities with members are open and accountable to those members, so that the members are in a position to understand the entity's operations and raise questions relating to its governance.

Reasonable steps that a registered entity could take to ensure that they are being accountable to members and ensuring the registered entity is open and transparent may include requiring that a quorum be met for a meeting of members, setting the frequency of member meetings, providing notices of member meetings, voting at meetings and allowing members to ask questions at meetings.

For example, a medium sized registered entity may have a process in place in which the request for items for the annual general meeting is sent out 45 days before the



meetings. If a member wants an item added to the agenda, they must notify the relevant responsible entity at least 20 days prior to the meeting. The agenda is circulated 10 days before the meeting.

It is the responsibility of these registered entities to take reasonable steps to be accountable to their members, and to allow those members adequate opportunity to raise concerns about the governance of the entity.

If a registered entity is currently meeting the requirements of the *Corporations Act 2001*, it would be complying with this Standard. As those obligations are ‘turned off’ when the Regulation commences, the Standard increases the flexibility of registered entities that are companies to decide how best to be accountable to their members in their particular circumstances.

The additional flexibility allows registered entities to adopt appropriate mechanisms tailored to their unique situations and minimise and reduce unnecessary compliance costs associated with existing detailed requirements.

If a registered entity is currently meeting the requirements of incorporated associations legislation in a State or Territory jurisdiction, it would also be complying with the Standard.

If a registered entity is currently meeting the requirements relating to members under the *Corporations (Aboriginal and Torres Strait Islander) Act 2006*, it would also be considered to be in compliance with the Standard.

#### Section 45.15 - Governance Standard 3 – compliance with Australian laws

Section 45.15 provides for Governance Standard 3, under which a registered entity must not engage in conduct, or omit to engage in conduct, that may be dealt with as an indictable offence under an Australian law, or by way of a civil penalty of 60 penalty units or more.

Compliance with Australian laws sets a minimum benchmark by which all entities should govern themselves. A failure by a registered entity to comply with an Australian law puts the public (including members, donors, employees, volunteers and benefit recipients of the registered entity) at risk and, therefore this Standard allows the Commissioner to take a proportionate approach to protect public trust and confidence, and the assets of the registered entity, and ensure the registered entity continues to operate in a manner that is sustainable and consistent with its purposes.

A registered entity would only breach this Standard if it engaged in activities that would amount to an actual breach of the law and could result in it being charged with an indictable offence or be liable to a civil penalty of 60 penalty units or more under an Australian law.

Indictable offences are offences punishable by imprisonment for a period exceeding 12 months, unless a contrary intention appears in the legislation creating the relevant offence. Under this Standard, the penalty units are calculated by reference to the current Commonwealth penalty unit calculations.

The registered entity does not need to be actually charged with an indictable offence, or given a penalty of 60 penalty units or greater, to be in breach of this Standard. For

example, if the ACNC reasonably believes that it is more likely than not that a registered entity has engaged in an offence of fraud, the registered entity would be in breach of this Standard and the ACNC could take action (for example, by issuing a formal warning) without the need for prosecution to be completed. This allows the ACNC to protect a registered entity from potential on-going misuse while legal proceedings are finalised.

This Standard does not apply in a way that extends Australian laws to overseas jurisdictions in which a registered entity may be operating. However, it does apply to an Australian law where that law extends to a particular overseas jurisdiction by other means, as some offences may apply to all Australian entities no matter where they operate (for example, Division 272 of the *Criminal Code*, which relates to child sex offences outside Australia).

#### Section 45.20 - Governance Standard 4 – suitability of responsible entities

Section 45.20 provides for Governance Standard 4, under which a registered entity must take reasonable steps to be and remain satisfied that each of its responsible entities is not disqualified from managing a corporation, within the meaning of the *Corporations Act 2001*, or disqualified by the Commissioner, at any time in the preceding 12 months, from being a responsible entity of a registered entity.

A responsible entity, as defined in section 205-30 of the Act, means an entity that is responsible for the control and/or management of a registered entity. This would include, for example, a trustee of a charitable trust or a director of a registered entity that is a company limited by guarantee.

This Standard also provides the mechanism by which the Commissioner may disqualify an entity from being eligible to be a responsible entity, or a particular type of responsible entity, where:

- the entity has been previously suspended or removed as a responsible entity of any registered entity, under Division 100 of the Act; and
- the entity has been given notice of its disqualification by the Commissioner; and
- the Commissioner reasonably believes that the disqualification is justified having regard to the objects of the Act.

Although not part of Standard 4, section 45.150 (in Subdivision 45-E) is necessary and convenient for giving effect to Standard 4 and provides for the Commissioner to maintain a register of disqualified responsible entities that will include the name of the disqualified entity, the date the entity was disqualified, and whether the disqualification can be subject to review.

As part of maintaining the register, the Commissioner will also be able to remove entities from the register once they are no longer a disqualified responsible entity. Entities will often cease to be a disqualified responsible entity 12 months after the Commissioner gives them notice of their disqualification (unless the Commissioner disqualifies them for an additional 12 months).

The disqualified responsible entities register is to be publicly available on a website maintained by the Commissioner. This enables registered entities and the public to

easily search the register and find the information they need in order to comply with the Standards and allow them to make informed decisions without additional compliance costs.

*Taking reasonable steps to ensure that responsible entities are not disqualified from managing corporations*

It is a registered entity's responsibility to take reasonable steps to ensure that all of its responsible entities are not disqualified from managing corporations. It must also consider whether each responsible entity remains eligible to manage corporations and take appropriate action if this is no longer the case. This means registered entities should take reasonable steps to be satisfied that their responsible entities are eligible to manage corporations, and have processes in place to alert them when an event occurs that makes a responsible entity no longer eligible or appropriate to manage a corporation.

Reasonable steps may include a search of the Australian Securities and Investments Commission (ASIC) Disqualified Persons Register and requiring responsible entities to sign a declaration that they do not have any relevant criminal convictions. It may also include seeking a commitment from its responsible entities that they will advise the registered entity should their circumstances change and they be disqualified from managing a corporation.

There are several provisions under the *Corporations Act 2001* which may result in persons being disqualified from managing corporations. ASIC is required to keep a register of persons disqualified under most of these provisions. Registered entities can search the online ASIC Disqualified Persons Register to determine if a potential responsible entity has been disqualified under these provisions.

However, persons can also be automatically disqualified from managing corporations under section 206B of the *Corporations Act 2001*. Where this occurs they will not necessarily be listed on an ASIC register. For that reason, registered entities may take steps to enquire as to whether an entity has been automatically disqualified (for example, through interview questions or a disclosure statement). The following matters result in automatic disqualification:

- if the person is convicted of an offence that is a contravention of the *Corporations Act 2001*, or of an offence that involves dishonesty and is punishable by imprisonment for at least three months;
- if the person is convicted on indictment of an offence that concerns the making, or participation in making, of decisions that affect the whole or a substantial part of the business of a corporation;
- if the person is convicted of an offence against the law of a foreign country that is punishable by imprisonment for a period greater than 12 months;
- if the person is an undischarged bankrupt (a separate register for this is maintained by Insolvency and Trustee Service Australia (ITSA));
- if the person has executed a personal insolvency agreement and the terms of the agreement have not been fully complied with; and

- if, under an order made by a court of a foreign jurisdiction, the person is disqualified from being a director of a foreign company or being concerned in the management of a foreign company.

*Taking reasonable steps to ensure that responsible entities are not disqualified by the Commissioner, at any time in the preceding 12 months, from being a responsible entity of a registered entity*

It is a registered entity's responsibility to take reasonable steps to ensure that all of its responsible entities are not disqualified by the Commissioner from being a responsible entity of a registered entity in the 12 months prior to their appointment.

To assist registered entities with this requirement, under section 45.150 of the Regulation, the Commissioner must maintain a register of disqualified responsible entities that will include the name of the disqualified entity, the date the entity was disqualified and whether the disqualification remains subject to review.

This enables registered entities to search the disqualified responsible entities register prior to appointing an entity as a responsible entity. A registered entity could then seek a commitment from its responsible entities that they will advise the registered entity should their circumstances change and they be disqualified by the Commissioner from being a responsible entity of a registered entity.

*Taking reasonable steps to remove a responsible entity for failure to meet the conditions in subsection 45.20(3)*

It is a registered entity's responsibility to remain satisfied that a responsible entity is not disqualified from being a responsible entity under the conditions in subsection 45.20(3). These conditions are described above and include not being disqualified from managing a corporation and not being disqualified by the Commissioner from being a responsible entity in the preceding 12 months.

If a registered entity does not remain satisfied that the responsible entity meets the conditions it must take reasonable steps to remove that entity. Reasonable steps may include calling a meeting of members to vote on the removal of the responsible entity, calling upon the responsible entity to resign, or ultimately, as a last resort, taking court action against the responsible entity or seeking a regulators' assistance.

*Disqualifying responsible entities*

This Standard also enables the Commissioner to disqualify an entity from being a responsible entity. These are largely machinery provisions designed to promote efficiency of the ACNC and the NFP sector so that the ACNC does not need to remove the same entity every time it seeks to be a responsible entity of different registered entities.

The Commissioner will only be able to disqualify an entity where that entity has already been suspended or removed in accordance with the Act. Under the Act, the Commissioner may only suspend or remove responsible entities where the registered entity is a federally regulated entity and the entity has contravened, or is likely to contravene, the Standards or the Act.

This Standard further provides that any entity that has been disqualified may lodge an objection with the Commissioner. Following receipt of an objection, the Commissioner will reconsider the decision. If the entity is still dissatisfied with the decision of the Commissioner following reconsideration, the entity may seek review of the decision through the Administrative Appeals Tribunal or the courts.

#### Section 45.25 - Governance Standard 5 – duties of responsible entities

Section 45.25 provides for Governance Standard 5, under which a registered entity must take reasonable steps to ensure that its responsible entities are subject to, and comply with, the following duties:

- exercising the responsible entity's powers and discharging 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;
- acting in good faith in the best interests of the registered entity, to further the purposes of the registered entity;
- not misusing the responsible entity's position;
- not misusing information obtained in the performance of the responsible entity's duties as a responsible entity of the registered entity;
- disclosing perceived or actual material conflicts of interest of the responsible entity;
- ensuring the financial affairs of a registered entity are managed in a responsible manner; and
- not allowing the registered entity to operate while insolvent.

These duties have been derived from the common law and the *Corporations Act 2001* and they have well established meanings. Consequently, it is intended that the meaning of these duties be interpreted with reference to the existing common law and relevant legislation.

Registered entities have a general responsibility to their donors, beneficiaries, volunteers and members (where applicable) as per their NFP character and to governments and the public at large, in part because they are in receipt of tax concessions or public funds. It is therefore expected that all responsible entities must be honest and careful in all their dealings on behalf of the registered entity at all times, and must always act in the entity's best interests.

#### *Taking reasonable steps to apply the duties*

A registered entity can choose which steps it takes (as are reasonable) to apply the duties in this Standard to its responsible entities, provided the responsible entities are made subject to the duties.

If the registered entity is already subject to State or Territory legislation that makes these duties applicable (such as the Incorporated Association legislation in each State and Territory jurisdiction), the responsible entity will already be subject to those duties.

Other reasonable steps a registered entity could take to apply the duties to its responsible entity could include having the duties set out in a contract of employment/letter of appointment, as part of a board charter, a code of conduct based on the duties, or specifying the duties of the responsible entities in the registered entity's governing rules (although there is no prescribed or mandatory form).

### *Undertaking the duties*

#### *Exercising care and due diligence*

When responsible entities exercise their powers and discharge their duties, they must do so with the degree of care and diligence that a reasonable individual would exercise if they were in the circumstances of that particular responsible entity.

Consistent with the equivalent director duty and case law, this involves consideration of the circumstances of the individual registered entity. In this manner, what a responsible entity of a small registered entity must do may be different to what the responsible entity of a large registered entity must do. Other factors to take into consideration are the type of registered entity and the distribution of functions within the registered entity.

For example, a large registered entity delegates much of the review of its technical compliance work to responsible entities with legal and accounting qualifications. Sally is an accountant on the Board of the registered entity. In determining the degree of care and diligence Sally should exercise in her conduct of the affairs of the entity, regard may be had to how a Board member of a similar sized registered entity with Sally's technical expertise and qualifications would normally exercise their powers and discharge their duties.

#### *Acting in good faith*

Responsible entities also need to act in good faith in the best interests of the registered entity, considering the purposes of the registered entity. Where there is a potential or actual conflict, they should put the registered entity's interests above their own interests.

#### *Not misusing position or information*

Responsible entities must not use their position or information obtained through their position to gain an advantage for themselves or someone else, or to cause detriment to the registered entity.

For example, a registered entity has governing rules which bind its responsible entities to the required duties. Mike, a responsible entity of the registered entity, tenders for a new government contract on behalf of the entity. Mike uses his knowledge of the registered entity's tender to put in a more competitive tender for his own private company.

However, as part of Mike's employment contract with the registered entity, in addition to the other duties to which Mike agreed to be bound, he undertook to not misuse his position or information gained in his position. For that reason, Mike's actions do not put the registered entity in breach of Standard 5, as he was bound not to misuse information provided to him in the course of being a responsible entity.

*Disclosing perceived or actual material conflicts of interest*

Registered entities need to ensure that their responsible entities disclose material conflicts of interest even if the conflict is only perceived. When considering what is a perceived material conflict of interest, it is based on an objective standard and a responsible entity must consider what a reasonable person or court would consider to be a perceived material conflict of interest

For example, Class C Inc is looking to engage a professional fundraiser. One of its responsible entities has a daughter who is a director of a major fundraising company. The responsible entity should disclose this information because that fundraiser may be a potential tenderer in the process.

There could be many ways in which a responsible entity could meet the disclosure obligations for a real or perceived material conflict of interest. To ensure that disclosure is made to the most relevant entities (and to ensure an opportunity for disclosure is available for all responsible entities), disclosure must be to:

- if the responsible entity is a director of the registered entity — the other directors (if any); or
- if the registered entity is a trust, and the responsible entity is a director of a trustee of the entity — the other directors (if any); or
- if the registered entity is a company (including an association or incorporated association) — the members of the registered entity; or
- in any other case — unless the Commissioner provides otherwise, the Commissioner, in the approved form.

Director in this context also includes a member of the committee of management of the company or an individual who performs the duties of such a member where the company is not incorporated.

If a registered entity has members as well as other directors, the responsible entity would need to disclose its conflict to its members only where it could not disclose the conflict to the other directors. An example of this would be where all of the directors had the same conflict of interest.

A responsible entity may also give standing notice of the nature and extent of a possible conflicting interest. Standing notice in this sense would mean that the responsible entity would not be obliged to bring its conflict of interest to the attention of the relevant entities every time the matter arises.

In the case where a registered entity cannot disclose the conflict to its members or other directors, the registered entity may be able to disclose the conflict to the Commissioner. In light of the possibility of causing unnecessary compliance costs in some circumstances, provision is made for the ACNC to not require disclosure.

Accordingly, registered entities will not need to disclose conflicts of interest to the Commissioner where the Commissioner believes the conflict, whilst material, is nonetheless of a low-risk nature that would cause unnecessary compliance costs. The ACNC will publish guidance on which conflicts of interest it will not require disclosure.

### Ensuring responsible management of financial affairs

Many registered entities receive donations, taxation concessions and/or government funding. There is a community expectation that they have responsible entities in place that ensure the responsible management of a registered entity's resources so that it can effectively achieve its purpose and protect its resources from misuse. This duty requires the registered entity to take reasonable steps to ensure its responsible entities ensure the financial affairs of the registered entity are managed in a responsible manner.

This duty is not meant to discourage responsible entities from being innovative or taking risks where appropriate but rather, it is meant to ensure that responsible entities consider the management of a registered entity's financial affairs and, where appropriate, address identified issues in relation to its financial affairs. This may be achieved in numerous ways.

There is not a benchmark or mandated approach to ensuring responsible management of financial affairs. However, it is reasonable to expect that a responsible entity will ensure that appropriate and tailored financial systems and procedures have been put in place, having regard to the size and circumstances of the registered entity as well as the complexity of its financial affairs.

Steps a responsible entity could take include putting in place or undertaking the general practices of the entity around the spending of funds (for example, who can write cheques or approve expenditure) as well as who bears the risk and what procedures should be followed if, say, fraud occurs. The responsible entity may also ensure the financial affairs are responsibly managed by having appropriate insurance in place and maintaining its currency. An audit committee may be another part of the arrangements for ensuring the financial affairs for very large registered entities are managed responsibly.

For example, a large registered entity is set up for the protection of the environment. The entity operates with a large number of volunteers, who undertake conservation work for the entity. Given the size of the entity, the large number of volunteers, and the outdoor nature of their work, the responsible entity decides to take out insurance to cover the risk of a volunteer being injured. This limits the financial risk to the entity should such an injury occur.

The processes required to meet this duty may include those that a registered entity may already be required to have in place to meet ACNC reporting requirements, such as having its accounts reviewed or audited.

### Not operating while insolvent

Registered entities must ensure that their responsible entities do not carry on the operations of the registered entity while it is insolvent. The term 'insolvent' is defined in the *Corporations Act 2001*.

## **Subdivision 45-C Protections under Governance Standard 5**

Subdivision 45-C provides for protections that apply in circumstances under which action taken by a responsible entity may otherwise result in a registered entity being in breach of Standard 5.



Satisfying the test set out in one of the protections means that the registered entity has not breached the Standard. These protections, in all cases, are targeted at the actions or state of mind of the responsible entity and are similar to the defences available in the *Corporations Act 2001*. A registered entity is to be deemed to have taken the reasonable steps necessary to be compliant with Standard 5, if the protections apply.

#### Section 45.105 - Protection 1

Protection 1 allows a responsible entity to rely on information provided by an employee of the registered entity, a professional adviser, another responsible entity and an authorised committee of responsible entities. The protection requires the responsible entity of the registered entity to have independently assessed any advice received before the responsible entity can rely on it, as is currently required under the *Corporations Act 2001*.

However, Protection 1 would protect a responsible entity if it turned out the information relied on was inaccurate, but it would have been unreasonable for the responsible entity to have known that, or had any reason to doubt the source of the information or its accuracy, and the responsible entity had independently assessed the information themselves.

#### Section 45.110 - Protection 2

Protection 2, is largely based on what is commonly known as the ‘business judgement rule’ and allows a responsible entity to rely on a decision they have made, in good faith and in the best interests of the registered entity, even if the outcome of the decision does not turn out to have been in the best interests of the registered entity (for example, following the decision, the economic climate changes, and the outcome of the decision is not as desirable as was expected). Protection 2 applies to the duty as described in paragraph 45.25(2)(a).

#### Section 45.115 - Protection 3

Protection 3 allows that the duty in respect of insolvent trading is not breached if the responsible entity had reasonable grounds to expect, and did expect, that the registered entity was solvent, and would remain solvent, at the time when a debt was incurred; or if the responsible entity took all reasonable steps to prevent the registered entity from incurring the debt.

#### Section 45.120 - Protection 4

Protection 4 ensures that a registered charity would not be in breach of Standard 5 because its responsible entity was absent, and could not have known they were in breach of a standard. For example, if a responsible entity was away for a period due to illness, and during this period the charity entered into a transaction which the absent responsible entity should have disclosed as involving a possible conflict of interest.

### **Subdivision 45-D Transitional arrangements**

Section 45.130 provides an exemption from the application of the Governance Standards (or particular Standards) for registered entities where particular circumstances arise.

Subsection 45.130(1) provides transitional relief for registered entities that are required to amend their governing rules in order to comply with a requirement in the Governance Standards. This transitional relief applies until 1 July 2017.

However, subsection 45.130(2) specifies that the transitional arrangements that apply under subsection 45.130(1) are contingent upon the registered entity attempting to comply with the Governance Standards as much as possible, without having the registered entity breach its governing rules.

Subsection 45.130(3) provides transitional relief to registered entities where they are an incorporated association that is subject to a State or Territory law that deals with incorporated associations and imposes duties on responsible entities. To the extent that the registered entity complies with the State or Territory law, they are taken to comply with Standard 5 until 1 July 2017.

The relevant State and Territory laws and specific provisions that this transitional relief is intended to apply to includes, but is not limited to:

State or Territory	Law of State or Territory
New South Wales	Sections 31, 32, 33 and 68 of the <i>Associations Incorporation Act 2009</i> (NSW)
Victoria	Sections 80 and 83 to 87 and section 152 of the <i>Associations Incorporation Reform Act 2012</i> (Vic)
Western Australia	Sections 21 and 22 of the <i>Associations Incorporation Act 1987</i> (WA)
South Australia	Section 31, 39A and 49AD of the <i>Associations Incorporation Act 1985</i> (SA)
Australian Capital Territory	Section 65 of the <i>Associations Incorporation Act 1991</i> (ACT)
Northern Territory	Sections 31, 32, 33 and 90 of the <i>Associations Act</i> (NT)

However, subsection 45.130(4) specifies that where a State or Territory amends its laws to align or adopt Standard 5, then the registered entity will be subject to the Standard as made.

This transitional provision serves to address duplication between the States and Territories (where they impose similar duties on the responsible entities of incorporated associations) and provide jurisdictions with additional time to develop measures to address duplication.

**ATTACHMENT B****Statement of Compatibility with Human Rights**

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

**Australian Charities and Not-for-profits Commission Amendment  
Regulation 2013 (No. 1)**

This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

**Overview**

The purpose of the Legislative Instrument is to specify governance standards with which registered entities must comply in order to become registered under the Act and to remain entitled to be registered under the Act.

**Human rights implications**

This Legislative Instrument does not engage any of the applicable rights or freedoms.

Whilst the Legislative Instrument provides for the publication of certain information by the ACNC, it does not engage with the right to privacy under Article 17 of the International Covenant on Civil and Political Rights (ICCPR) because it does not involve the collecting, using, storing and sharing of personal information.

The Legislative Instrument provides for the publishing of certain information about individuals but that information is not personal information.

**Conclusion**

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues.

**Assistant Treasurer, the Hon David Bradbury**