

Charities Alert

February 2013

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- Update on taxing NFPs for conducting certain unrelated commercial activities

Governance standards for charities

The Australian Treasury has released a consultation paper (**paper**) on *Development of Governance Standards* for the not-for-profit (**NFP**) sector. The government is calling for submissions by 15 February 2013 with an aim to have the final standards in place before 1 July 2013 under regulations to be made pursuant to the *Australian Charities and Not-for-profits Commission Act 2012 (ACNC Act)*.

In this article, we focus on the essence of the draft standards, how they would affect the governance of charities that are companies limited by guarantee registered under the *Corporations Act 2001 (Cth) (Corporations Act)* and timing obligations for compliance with the governance standards. The governance standards will not apply to basic religious charities as defined in the ACNC Act.

The paper contains useful background material as well as commentary on the draft standards and can be accessed [here](#).

Background

To understand what is proposed, it is necessary to be clear on two somewhat confusing expressions defined in the ACNC Act:

- **'registered entity'** means an entity, a charity, that is

registered under the ACNC Act. The term 'registered entity' is defined and used in the ACNC Act. The paper instead uses the expression 'registered charity', and we have also done that in this article.

- **'responsible entity'** means an individual (or in some limited cases, a corporation) who is responsible for running a registered charity. In most cases, this will be the directors or committee members of a registered charity. We find this an awkward definition that will likely lead to some confusion about who is running a charity and the charity itself.

The governance standards are intended to reflect a minimum set of outcomes for registered charities rather than to mandate 'best practice governance' or detailed procedures and requirements.

In the following paragraphs of this Alert we summarise the main aspects of each standard and comment on them.

Draft governance standard 1 – Purposes and NFP nature of a registered charity

A registered charity must:

- be able to demonstrate, by reference to the governing rules of the charity or by other means, its purposes and its character as a not-for-profit entity;
- make information about its purposes available to the public including members, donors, employees, volunteers and benefit recipients; and

- comply with its purposes and character as a not-for-profit entity.

Comments:

- Most charities will already comply in substance with paragraphs (a) and (c) of this standard in complying with requirements of the Australian Taxation Office (ATO). However, it will be timely to ensure that the charity's governing rules comply with this standard.
- The paper points out that compliance with paragraph (b) could be achieved by publishing information on a charity's website, or potentially from what is disclosed on the ACNC register.

Draft governance standard 2: Accountability to members

A registered charity that has members must take reasonable steps to ensure that:

- the registered charity is accountable to its members; and
- the registered charity's members have an adequate opportunity to raise concerns about its governance as a registered charity.

Comments:

- For registered charities that are companies limited by guarantee, the Corporations Act provisions relating to meetings of members will no longer apply after 1 July 2013. Those charities will have the flexibility of either retaining similar provisions in their constitutions or adopting alternative mechanisms of complying with this standard.
- For registered charities that are incorporated associations, compliance with state legislation will comply with this standard.

Draft governance standard 3: Compliance with Australian laws

A registered charity 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 civil penalty of 60 penalty units or more.

Comments:

- It is only conduct that would breach serious offences that will breach this standard. Charities are of course required to comply with all laws that apply to them regardless of this standard.

- It is not necessary to be charged or convicted of a serious offence to breach this standard – the ACNC may itself form the view that conduct has breached this standard, and take action against the charity.

Draft governance standard 4: Responsible management of financial affairs

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

Comments:

- This standard is deliberately broadly phrased to enable registered charities to plan their 'reasonable steps' in light of their own circumstances and financial affairs.
- The paper notes that the standard is not just a matter of accounting – insurance is an important issue for all charities and large charities need to consider issues such as audit committees.

Draft governance standard 5: Suitability of responsible entities

In essence:

- a registered charity must take reasonable steps to ensure that each of its responsible entities meets and continues to meet the suitability conditions specified below;
- the suitability conditions are that the responsible entities must not be disqualified from managing a corporation or disqualified by the ACNC Commissioner from managing a registered charity.

Comments:

- Compliance with this standard will not be onerous, but registered charities will need to make inquiries to establish that its 'responsible entities' meet the suitability conditions, including searching the ASIC register of disqualified directors.
- The paper notes that other legislation continuing to apply to registered charities may impose other restrictions on who can govern charities.

Draft governance standard 6: Duties of responsible entities

A registered charity must take reasonable steps to ensure that its responsible entities are subject to, and comply with, the following duties:

- to exercise the responsible entity's powers and discharge the responsible entity's duties with a degree of care and diligence that a reasonable individual would exercise if they were a responsible entity of the registered charity;
- to act in good faith in the best interests of the registered charity, to further the purposes of the registered charity;
- not to misuse the responsible entity's position;
- not to misuse information obtained in the performance of the responsible entity's duties as a responsible entity of the registered charity;
- to disclose perceived or actual material conflicts of interest of the responsible entity;
- not to allow the registered charity to operate while insolvent.

This standard also has specific protections to its operation so that the standard will be complied with where there is reliance on information including professional or expert advice in good faith, and after making independent assessment of information if information is given by appropriately qualified employees and advisers or other responsible entities

There is also a general protection in relation to decisions made in good faith for a proper purpose, without any material personal interest, where the responsible entity has informed itself about the subject matter of the decision to an extent reasonably believed to be appropriate, and the responsible entity rationally believes that the decision is in the best interests of the registered charity. This protection is substantially the same as the 'business judgement' protection in s180 of the *Corporations Act*.

A responsible entity will meet the standard of not allowing a registered charity to operate while insolvent if the responsible entity had reasonable grounds to expect that the registered charity was solvent, and would remain solvent after incurring any debt, and that the responsible entity took reasonable steps to prevent the registered charity from incurring the debt.

Comments:

- Most statutory and general law duties are duties of the office bearers themselves, and they are the ones responsible for any breach. Whereas the ACNC governance standards are obligations of the registered charity to 'take reasonable steps to ensure that its responsible entities are subject to, and comply with' the duties in governance standard 6. Therefore, if there is a breach that will be a breach by the registered charity itself and there is no direct statutory obligation on the responsible entities.
- To make its responsible entities subject to the governance standard 6, the registered charity would need to make a contract with its responsible entities requiring them to comply with the standard, or to insert that obligation in the registered charity's governing documents or board charter and ensure that all its responsible entities are committed to comply with those documents. If a director breaches that commitment, enforcement will be solely a matter for the guarantee company itself and there is no civil penalty recoverable by ACNC although ACNC may take action to remove the responsible entity that is in breach.
- A note to standard 6 recognises that higher or other duties or standards may be imposed by other Australian laws (in addition to the standards) including where a registered charity is bound to comply with specific statutory duties in relation to investments, fiduciary duties and obligations of responsible entities and additional duties on registered charities that act as trustees.
- Unless and until state and territory incorporated association legislation is amended, registered charities that are incorporated associations, and their responsible entities, will continue to be bound by existing obligations. The protections to standard 6 will not apply to those other legislative obligations

Consequences for guarantee companies – don't throw away your Corporations Act!

Many charities are incorporated as companies limited by guarantee registered under the *Corporations Act* (**guarantee companies**). The *Australian Charities and Not-for-profits Commission (Consequential and Transitional) Act 2012 (ACNC Transition Act)* specifies provisions of the *Corporations Act* that do not apply to bodies corporate registered under the ACNC Act. As we set out in our [December 2012 Charities Alert](#), a number of those changes have already taken effect relating to matters such as changes to constitution and notifying information about changes of directors etc.

As the paper states, changes set out in the ACNC Transition Act that commence on 1 July 2013 'turn off' certain director and officer duties for guarantee

companies once they are obliged to comply with the ACNC governance standards. The changes from the present position that will take effect on 1 July 2013 are summarised in the following table:

Duties of directors and officers of guarantee companies that are also registered with ACNC (references to sections are to the Corporations Act)	
Up to 30 June 2013	From 1 July 2013
Exercise due care and diligence – section 180 (business judgment rule protection applies)	Directors must be made subject to similar duty (with business judgment rule protection) – standard 6(2)(a) and protection 2. Section 180 no longer applies.
Exercise powers in good faith and for a proper purpose – section 181 (business judgment rule protection does <i>not</i> apply)	Directors must be made subject to similar duty (with business judgment rule protection) – standard 6(2)(b) and protection 2. Section 180 no longer applies.
Not improperly use position to gain advantage for self or others or cause detriment to company – section 182 (business judgment rule protection does <i>not</i> apply)	Directors must be made subject to similar duty (with business judgment rule protection) – standard 6(2)(b) and protection 2. Section 180 no longer applies.
Not improperly use company information to gain advantage for self or others or cause detriment to company – section 183 (business judgment rule protection does <i>not</i> apply)	Directors must be made subject to similar duty (with business judgment rule protection) – standard 6(2)(c) and protection 2. Section 180 no longer applies.
Recklessly or dishonestly fail to act in good faith and for a proper purpose – section 184(1)	Criminal offence in section 184(1) continues to apply
Dishonestly or recklessly use position or information to gain advantage for self or others or cause detriment to company – section 184(2) and (3)	Criminal offences in section 184(2) and (3) continue to apply
Protection for good faith acting in interests of holding company, when director of a subsidiary - section 187	Section 187 protection continues to apply
Officers of company also bound by sections 180 to 184	Officers who are not responsible entities, no longer bound by sections 180 to 183. Remain liable for criminal offences under section 184.
Employees of company also bound by sections 182 and 183.	Employees no longer subject to these statutory duties
Failure of directors or secretary to make lodgements with ASIC – strict liability offence in section 188	Offence continues in relation to lodgements still required to be made with ASIC
Reliance on information or advice provided by others – section 189	Section 189 still applies and in addition protection 1 to standard 6 also applies
Power to delegate to committees, employees and others and responsibilities for delegate's actions – sections 198D and 190	Sections 198D and 190 continue to apply. No equivalent in the standards
Disclosure of directors' interests – sections 191 to 194	Simplified obligation to disclose 'perceived or actual material conflicts of interest' – standard 6(2)(e), note 3 and 6(3)
Not to engage in insolvent trading – section 588G and related provisions imposing personal liability on directors	Insolvent trading regime in Corporations Act continues to apply. In addition, proposed standard 6(2)(f) will require registered charities to take reasonable steps to ensure its responsible entities do not allow insolvent trading

As a result of the introduction of the ACNC regime, guarantee companies are now subject to regulation by both ACNC and ASIC in relation to different issues. In essence:

- setting up a guarantee company remains with ASIC;
- most, but not all, issues relating to the operations of the guarantee company will then be regulated by ACNC;
- matters relating to criminal offences by directors of guarantee companies, their liquidation and other forms of external administration and subsequent deregistration will remain ASIC's responsibility; and
- in some situations provisions of both the ACNC governance standards and of the *Corporations Act* will both continue to apply – e.g. notifying a change of name.

Apart from the capacity for a measure of ongoing confusion as to whether the governance standards or the *Corporations Act* applies (or in some cases both), the main consequences of the new regime in relation to duties of directors and officers of guarantee companies are:

- most *Corporations Act* duties also apply to officers, an expression that covers a broader range of people than 'responsible entity'. For example a senior financial manager who is not also a director of a guarantee company will not be a responsible entity to which standard 6 applies.
- protection in relation to standard 6 (the equivalent of the 'business judgment rule' in the *Corporations Act*) will apply to all of the duties set out in standard 6, not just the duty of care and diligence as is the case under the *Corporations Act*.

Regulatory Duplication

The paper recognises that without changes to state and territory legislation (particularly relating to charities that are incorporated associations), there will be regulatory duplication for registered charities in complying with both ACNC and existing state requirements, including provisions regulating governance of incorporated associations.

Without Australia wide legislative reform, a charity operating in all states and territories will continue to be subject to the jurisdiction of many different regulators (Commonwealth and State) in relation to its structure, fundraising and revenue exemptions.

In recognition of this duplication, the Council of Australian Governments (COAG) has released a consultation Regulatory Impact Assessment (RIA) seeking submissions

on ways to reduce regulatory duplication. A link to the RIA is [here](#). Submissions on the RIA are due by 21 February 2013.

The RIA does not quantify any potential additional regulatory burden imposed by the ACNC regime, and in particular does not consider the costs and benefits of changes made to guarantee companies that we have discussed in the preceding section of this Alert.

The RIA identifies that compliance with proposed standard 6 (duties of responsible entities) is the most significant area of duplication for incorporated associations. The RIA contains an informative table showing for each charity structure (other than guarantee companies) the estimated degree of burden imposed from each of the governance standards and from financial and other reporting to ACNC. The table is set out below for ease of reference. The table is a telling snapshot showing how much additional Australia wide legislative reform is still required before the government's aim of reducing red tape for charities will be achieved.

Please refer to the COAG table on following page.

Timing

The governance standards are proposed to commence on 1 July 2013. It is proposed that registered charities will have 18 months from the commencement of the governance standards to make any necessary changes (for example, to internal procedures), to meet the governance standards. An exception to this is in relation to changes required to a registered charities' governing rules, in which case there will be 4 years from 1 July 2013 to make the necessary changes. However, if a registered charity chooses to make its responsible entities subject to the duties in standard 6 by way of its governing rules rather than by contract with individual responsible entities, it will need to amend its governing rules by 31 December 2014.

It would be highly desirable that before the governance standards come into force, the government announce the result of its separate review of the use of guarantee companies for the conduct of charities. At a recent community consultation conducted by ACNC, a Treasury spokesperson indicated that review was not addressing the issue of whether to replace the guarantee structure with a different one, but rather ways of improving that structure when it is used by charities. However, it is important that charities conducted as guarantee companies know as soon as possible what other action, if any, the government is proposing to take that will affect their structure, before they finalise amendments to their constitutions and governance procedures to comply with the ACNC regime.

TABLE: Summarising COAG impact analysis¹

Burden is indicated by coloured 'traffic lights', with:

 Red indicating greatest regulatory duplication burden (change to existing systems or multiple reporting is required for charities);

 Yellow indicating where a Standard does not apply to an entity type

 Green indicating no burden (no change is required)

 Black indicating new and additional requirements for charities. As these requirements do not give rise to regulatory duplication between the Commonwealth and States and Territory regulators, they have been identified but not costed. Nevertheless, it is noted that these requirements will result in additional costs for charities.

	Incorporated associations	Trusts	Unincorporated associations	Cooperatives	Other bodies
Standard 1: Governing rules					
Standard 2: Accountability to members					
Standard 3: Compliance with Australian Law					
Standard 4: Responsible management of financial affairs					
Standard 5: Suitability of responsible entities					
Standard 6: Duties of responsible entities					
Entity tiers					
Annual Information Statement					
Annual Financial Statement					
Notifying ACNC of changes					
Additional reporting					
Group reporting					

1. Source: Paragraph 133, COAG RIA, January 2013

Financial reporting for charities

The Assistant Treasurer has released an extract from the draft *Australian Charities and Not-for-profits Commission Regulation 2012 (the Draft Regulation)* and related Explanatory Material (**Explanatory Material**) outlining the proposed financial reporting requirements applying to charities registered with the ACNC. Comments on the Draft Regulation are sought by 15 February 2013. [Click here](#) to view the treasury website.

The financial reporting requirements under the ACNC framework are proportional to the value of revenue of the registered charity and are consistent with existing thresholds that apply to companies limited by guarantee.

This Alert discusses financial reporting for registered charities. Financial reporting is not to be confused with the Annual Information Statement, which is required to be provided to the ACNC by all registered charities. The exact form of the Annual Information Statement is yet to be settled, however it will certainly require far less financial information than the financial reports discussed in this Alert.

The Explanatory Material indicates that, as a transitional arrangement, the ACNC will not be seeking financial information in the first Annual Information Statement, which is due by 31 December 2013 (or if your charity has an approved substituted reporting period, within 6 months of the end of the reporting period that commences after 1 July 2013), but will begin to require financial information in Annual Information Statements from the 2013/2014 financial year.

Which registered charities need to provide financial statements?

Medium and large registered charities will be required to provide annual financial reports to the ACNC. For large registered charities, financial reports will need to be audited. For medium registered charities financial reports may be either audited or reviewed.

The *Australian Charities and Not-for-profits Commission Act 2012 (Cth)* (**the Act**) provides that medium registered charities may choose whether to have their financial statements reviewed or audited. As the terms suggest, a review is less rigorous than an audit. An audit must be conducted by a registered company auditor, while a review may be performed by a wider class of persons provided that they hold the necessary designation.

If your charity is a Basic Religious Charity (**BRC**), financial reporting is not mandatory. However, if a BRC does provide the ACNC with a financial report, it must comply with the regulations for financial reporting.

Type of Charity	Annual Financial Report Required?
Large registered charity Annual revenue of more than \$1 million	Yes – Audited Financial Reports
Medium registered charity Annual revenue of \$250,000 or more, but less than \$1 million	Yes – Reviewed or Audited Financial Reports
Small registered charity Annual revenue of less than \$250,000	No
Basic Religious Charity	No, regardless of size

When do registered charities need to submit financial statements?

Registered charities will be required to prepare their first reports for the 2013/2014 financial year. Therefore, the first financial report will need to be lodged with the ACNC by 31 December 2014, or if the registered charity has an approved alternate accounting period, within six months after the end of the period.

What standards apply to financial reporting?

The Draft Regulation provides that the financial report for a registered charity consists of three elements:

- the financial statements;
- the notes to the financial statements; and
- a declaration made by the responsible entities regarding the accuracy of the financial statements and notes.

Generally, large and medium registered charities will need to ensure that their financial statements and notes comply with 'accounting standards'. Accounting standards under the ACNC framework are the those already established under the *Corporations Act 2001 (Cth)* and are essentially those set by the Australian Accounting Standards Board (**AASB**).

Whether or not a registered charity needs to prepare the full set of financial statements depends on whether the charity is a 'reporting entity' as defined by the accounting standards. In essence, a registered charity is a 'reporting entity' if it would be reasonable to expect individuals or companies would rely on the charity's general purpose financial statements to assist them to make decisions about

the allocation of resources. (For the full definition see, AASB 1053 Application of Tiers of Australian Accounting Standards.)

We note that while the accounting standards provide that a *'reporting entity can be a single entity or a group comprising a parent and all of its subsidiaries'*, a reporting entity under the ACNC framework is at the registered entity level, unless joint or collective reporting applies.

A registered charity that is a reporting entity must either prepare General Purpose Financial Reports (**GPFR**), which requires production of the full suite of accounting standards, or may choose to adopt the Reduced Disclosure Requirements regime (**RDR**) established under the accounting standards. A charity that does not meet the 'reporting entity' test is a 'non reporting entity' and can prepare either special purpose financial reports (**SPFR**), or GPFR if it wishes to do so.

Determining whether a charity is a 'reporting entity' is important, as it will determine the level of disclosure required in the financial report. As noted in the Explanatory Material, the mere fact that the financial statements will be made available on the ACNC public register does not necessarily mean that they need to be GPFR. Making a decision about classifying a registered charity depends on whether there are external users of the reports, and on the requirements set out in the accounting standards. The Explanatory Material provides some further guidance, and examples about how charities should be classified.

The overriding principle of the Draft Regulation is that financial statements and notes *'provide a true and fair view of the financial position and performance of the registered entity'*. If the financial statements and notes prepared in accordance with the accounting standards do not provide a true and fair view, then additional information must be included.

What declaration is required?

The Draft Regulation requires 'responsible entities' - the individuals managing the charity or, in some limited cases, a corporation - to provide a declaration regarding the charity which states:

- whether, in their opinion, there are reasonable grounds to believe that the registered charity is able to pay all of its debts, as and when they become due and payable; and
- whether, in their opinion, the financial statements and notes satisfy the requirements of the Act.

The declaration forms a part of the financial report that

will need to be lodged with the ACNC for the 2013/2014 financial year.

Exceptions to applying the accounting standards

The Draft Regulation provides for a number of circumstances in which the Act may be inconsistent with accounting standards. To the extent of the inconsistency, compliance with the accounting standards is waived.

Joint and collective reporting

The Act provides for the ACNC to approve joint reporting of two or more registered charities as a group or collective reporting in certain circumstances.

In order to lodge joint or collective reports, a registered charity must make an application to the ACNC in the approved form. This would need to be done well in advance of lodgement dates so that appropriate arrangements can be made within the organisation to accommodate the joint or collective reporting requirements. Section 60.95(4) of the Act sets out the matters that the Commissioner must consider when deciding whether to permit two or more registered charities to form a reporting group. These matters include how the public interest in transparency and accountability of the charity is best served, how the reporting arrangements would affect the ACNC, the ATO's ability to assess the charity and the charity's costs of compliance and administration.

When making a decision to permit a registered charity to report as a group, the Commission may impose certain conditions regarding certain information and the manner of reporting.

Additional reporting requirement specified by the ACNC

The Commissioner may require a registered charity to provide additional information or reports. These requests may be in addition to information required under accounting standards. It is envisaged that this type of request would be used in circumstances where, for example, there is reason to believe a registered charity has contravened the Act.

Comparative year reporting

The Draft Regulation provides that comparative year figures are not required for the 2013/2014 financial reporting year, despite the fact these figures are normally required by the accounting standards. This ensures that registered charities need only comply with accounting standards from 1 July 2013.

Transitional arrangements for reports provided to other government agencies

The *Australian Charities and Not-for-profits Commission (Consequential and Transitional) Act 2012 (Cth)* allows accounting reports provided to other Australian government agencies to be accepted as financial reports under the ACNC framework up until the 2014/2015 financial year. When considering whether to accept such a report, the Commission may have regard to the ease of access the Commission has to the report, whether the report contains the information required by the Act and the process required to verify the information contained in the report. For non-government schools, the Commissioner will accept reports lodged under section 24 of the *Schools Assistance Act 2008* until at least the 2014/2015 financial year.

It is hoped this provision will ease the burden of duplication in reporting as the ACNC establishes itself as the 'one-stop shop' for reporting by charities.

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Update on taxing NFPs for conducting certain unrelated commercial activities

On 31 January 2013, the Government announced that the changes to tax not-for-profits (**NFPs**) for conducting certain unrelated commercial activities will commence from 1 July 2014, instead of 1 July 2012.

In the 2011-12 Federal Budget, the Government announced that it would change the tax concessions provided to NFPs. The changes will affect certain charities and other NFPs conducting certain commercial activities. The new arrangements were previously proposed to commence on 1 July 2012. On 27 May 2011, the Government issued a consultation paper – *Better Targeting of NFP Tax Concessions*, to seek public views on possible approaches to implement its budget announcement.

On 31 January 2013, the Government announced that the start date will be 1 July 2014 instead of 1 July 2012. The start date of 1 July 2014 is proposed to apply to activities that commenced after 7:30pm (AEST) on 10 May 2011. The measure will not impact on tax concessions relating to these activities prior to 1 July 2014.

The Government also announced that there will be transitional arrangements for certain unrelated commercial activities that commenced before 7:30 pm (AEST) on 10 May 2011 - they will not become subject to the measure until 1 July 2015. The measure will not impact on tax concessions relating to these activities prior to 1 July 2015. No further detail about the proposed law was given.

The proposed law raises a number of issues:

- What is an 'activity' and when will it be an 'unrelated commercial activity'?
- Would identification of the existing activity be by reference to the overall business or to particular activities?
- Would a change to any existing unrelated commercial activity or government contract in existence before 7.30pm (AEST) on 10 May 2011 cause the activity or contract to become a new activity, such that the new rules would apply from 1 July 2014?
- Should charities structure/ restructure their activities to achieve their commercial outcomes and objectives? If so, when should they do it and how?

The Government will have further consultation and engagement with the NFP sector on the proposed changes.

We will be monitoring progress with this proposed reform and including updated information in future editions of our Charities Alert when more information is available.

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