

# Legal Essentials for Not-for-Profits

For Purpose Conference - 2017



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CLIFFORD GOULDSON  
LAWYERS

## 1. My background & experience

### 1. Reports/resources referenced today:

- ACNC Charity Compliance Report December 2012-December 2014 and beyond (**ACNC Compliance Report**)
- Australian Charities Report 2015 (**Charities Report**)
- BDO Not-For-Profit Fraud Survey 2014 (**Fraud Survey**)
- Institution of Community Directors Australia 2015 Not-for-Profit Finance & Governance Insights (**Community Directors Survey 2015**)
- *Commonwealth Bank v Friedrich & Others* (1991) 5 ACSR 115 (**National Safety Council case**)

# Outline:

1. Understanding your legal & regulatory environment – why it is so important
  - Common issues
2. Basics of structures and regulators
  - Restructuring trends
3. Governance – directors duties & common governance gaps
4. Legal advice
  - When do we need it?
  - What do I need to know before engaging a lawyer?

## Are you/your Board among the ‘structurally unaware’?

- Have you read your Rules/Constitution?
- Do you know what legislation you must comply with?
- Can you list your organisation’s tax endorsements?
- Can you name all your regulators?

# The 'structurally unaware' – war stories

1. Rules? What Rules?
2. NFP in a Pty Ltd
3. Our Constitution – do we need to follow what it says?
4. What directors duties?
5. We can do things outside our objectives... can't we?

# Know your structure

1. Unincorporated groups
2. Incorporated associations
3. Company limited by guarantee
4. Indigenous corporations
5. Funds and trusts
6. Organisation created by Act/charter

# Why are particular structures usually chosen at establishment?

## 1. Unincorporated groups

- no initial costs
- longevity unclear
- to qualify as 'Basic Religious Charity' to avoid reporting to ACNC

## 2. Incorporated associations

- State-based
- low set-up and running costs

## 3. Company limited by guarantee

- National operation
- Company structure required by funder

# Why are particular structures usually chosen at establishment?

3. Indigenous corporations
  - allows for traditional customs
  - can be for profit or NFP – constitution must state this
4. Funds and trusts
5. Organisation created by Act/charter



# Governing documents of different structures

Structure	Governing document
Unincorporated association	There may be unofficial 'rules'
Incorporated association	Rules - either the 'model' rules can be adopted or association-specific rules
Companies limited by guarantee	Constitution
Indigenous corporations	Constitution (must specifically set out NFP status)
Funds and trusts	Trust deed
Organisations created by Act/Charter	Provisions of the Act/Charter

# Regulatory environment

1. Depends on your structure
2. Depends on whether you are a 'charity' or not

# When is your organisation a 'charity'?

- How many charities are there? 50,908 registered (Charities Report) – of the approximately 600,000 NFP's
- Definition of 'charity' in the *Charities Act 2013* (Cth) or common law definition.
- If you are a charity – since 2013, can now register with the ACNC

# Regulation and charitable status

- Not required to register with ACNC as a charity – but registration is required to access tax concessions
- Further obligations:
  - Additional, more onerous reporting obligations (particular for incorporated associations) – the level of financial reporting depends on annual revenue (small, medium & large)
  - Required to comply with ACNC governance standards
  - Need for ‘responsible persons’

# NFP/charities and tax exemptions/concessions

- Income tax exemption
- Capital gains tax exemption
- FBT exemption or rebates
- Deductible gift recipient status (DGR)
- GST concessions
- Franking credits refunds
- Payroll tax exemption
- Land tax exemption
- Transfer duty exemption
- Vehicle registration/Council rates etc

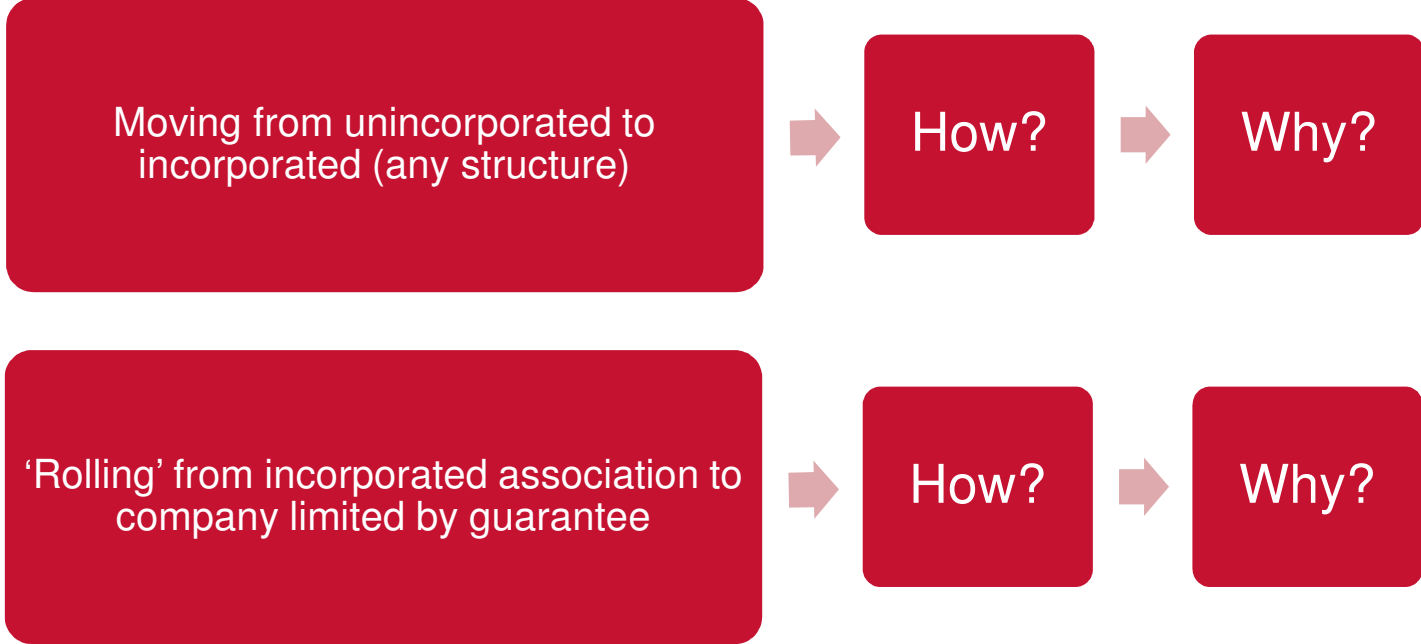
## Regulatory environment – who are the regulators?

Structure	ATO <i>(less if charitable)</i>	OFT	ASIC <i>(less if charitable)</i>	ACNC (if charity)	ORIC
Unincorporated association	✓			✓	
Incorporated association	✓	✓		✓	
Companies limited by guarantee	✓		✓	✓	
Indigenous corporations	✓			✓	✓
Funds and trusts	✓			✓	
Organisations created by Act/Charter	✓			✓	

# Regulatory environment – relevant legislation

Structure	<i>Associations Incorporation Act 1981 &amp; regulations</i>	<i>Corporations Act 2001 &amp; regulations</i>	<i>Australian Charities and Not- for-profits Commission Act 2012</i>	<i>Corporations (Aboriginal and Torres Strait Islander) Act 2006</i>	<i>'Other'</i>
Unincorporated assoc			✓		✓
Incorporated assoc	✓		✓		✓
Companies limited by guarantee		✓	✓		✓
Indigenous corporations			✓	✓	✓
Funds and trusts			✓		✓
Organisations created by Act/Charter			✓		✓

# Restructuring – current trends





# Restructuring - association to company

## Why do it?

- Operating across State borders – although the Charities Report revealed 79% operate in a single State.
- Funders requirement
- Merging with another organisation/s
- To avoid duplication of reporting (especially for charitable associations)

## Why not do it?

- ‘Don’t fix what isn’t broken’
- Company regulatory environment is stringent (especially for non-charity associations)
- Costly and time consuming

# Directors duties – what are they?

## Depends on your structure

- Non-charitable incorporated associations – obligations imposed by the *Associations Incorporations Act* and common law (*Corporations Act duties largely arose from this*)
- Charitable organisations – standard 5 of the governance standards set by the ACNC (similar to directors duties)
- Non-charitable companies limited by guarantee – directors duties imposed by the *Corporations Act*

# Directors duties – who do they apply to?

May be broader than you think:

- De facto directors
- Shadow directors
- Officers

# Director duties – an overview

ACNC Standard 5	Corporations Act / common law	
To act with reasonable care and diligence	Exercise powers & discharge duties with the degree of care & diligence that a reasonable person would exercise if they were a director/officer of a corporation in the same circumstances & occupied the same office, with the same responsibilities... as the director/officer.	s180
To act honestly & fairly in best interests of charity & for its charitable purposes	Exercise their powers & discharge their duties in good faith in the best interests of corporation and for proper purpose.	s181
Not to misuse their position or information they gain as a responsible person	<ul style="list-style-type: none"> <li>▪ Not improperly use their position to gain advantage for themselves/someone else or cause detriment to corporation</li> <li>▪ Person who obtains information because are/have been a director/officer/ employee of corporation must not improperly use information to gain advantage for themselves/someone else/cause detriment to corporation.</li> </ul>	s182 & s183

## Director duties – an overview cont...

ACNC Standard 5	Corporations Act / common law	
To disclose conflicts of interest	A director of a company who has a material personal interest in a matter that relates to the affairs of the company must give the other directors notice of the interest unless.. ( <i>exception applies</i> ).	s191
To ensure that the financial affairs of the charity are managed responsibly	Common law fiduciary duty of care, skill and diligence	
Not to allow the charity to operate while it is insolvent	Directors must ensure they don't allow the company to trade while insolvent (or incur a debt which triggers insolvency), if they fail to prevent the incurring of the debt and the director was aware (or a reasonable person would have been aware) of grounds for suspecting the insolvency, the director can be personally liable for debts incurred after point of insolvency.	s588G

# Directors duties... but if there is a breach, will any action really be taken?

- Prosecution from OFT/ASIC/ACNC
  - Charitable portion of sector has \$134 billion income (*Charities Report*)
- Governance/compliance issues might trigger ACNC investigation
  - ACNC Compliance Report includes 'case studies' of how this happens
- National Safety Council case
  - Director of NFP personally liable for \$97mill of debt incurred after point of insolvency due to a failure to discharge duties

## National Safety Council – the poster-child of governance issues

- Fraudulent CEO
- Assets were borrowed against that did not exist
- Inappropriate delegation of important Board responsibilities
- Operationally - no policies or procedures
- A Board asleep at the wheel – no diligence or follow through
- A well-meaning Board who lacked basic financial understanding

# Common NFP governance gaps

1. Not knowing your legal documents
2. Lack of good process
3. Lack of risk management
4. Lack of clear delegations to staff
5. Lack of internal controls
6. Poor performing Board – wrong composition & disengaged



# Common NFP governance gaps

## 1. Not knowing your legal documents

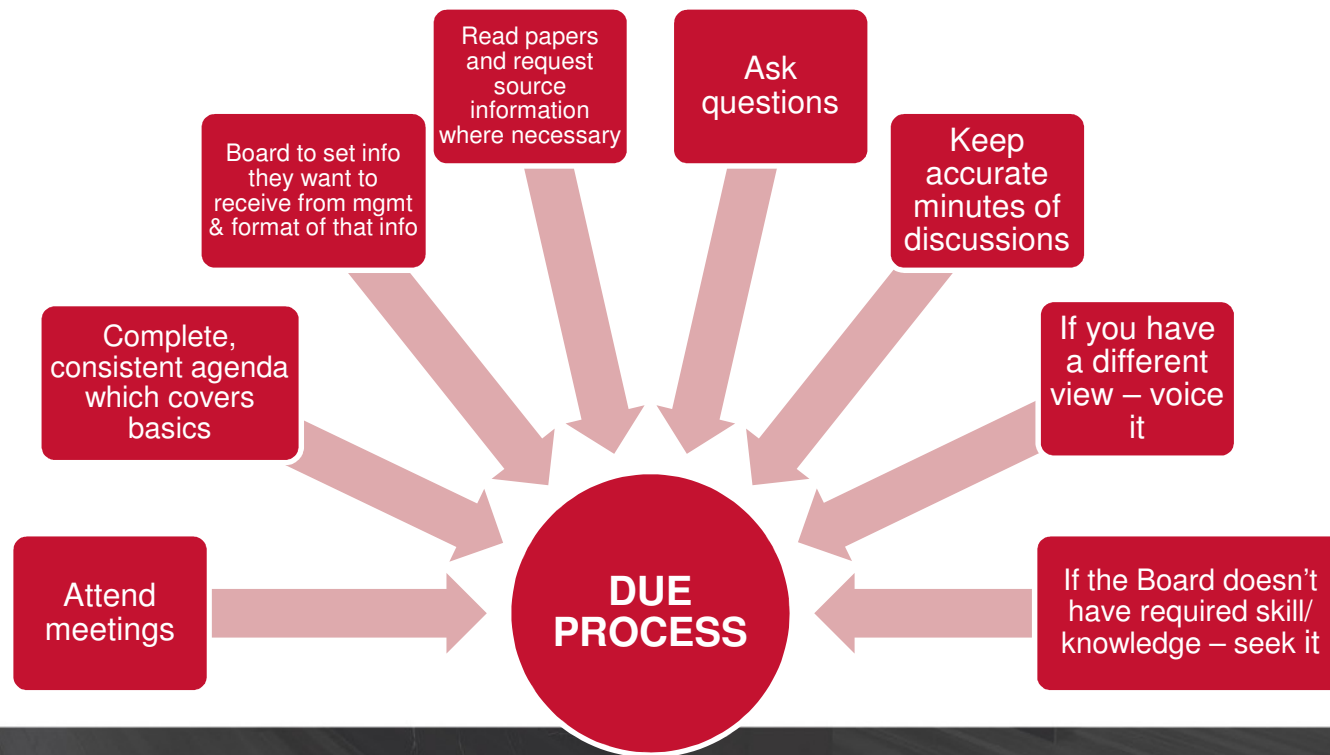
- Compliance with these basics sets the groundwork for good governance
- Failing to follow the constitution – has been identified by the ACNC in the *ACNC Compliance Report* as a component of many complaints to them.

# Common NFP governance gaps

## 2. Lack of good process

- Having good processes will ensure there has been minimum diligence to discharge directors duties and legal obligations.

# Common NFP governance gaps – good process



# Common NFP governance gaps

## 3. Lack of risk management

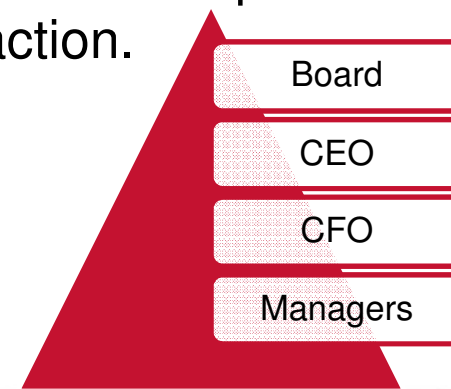
- NFP sector is often viewed as being conservative in relation to risk – why?
- At the same time, also a common view that there is a lack of good risk management – why?
- Why is risk management important?
- Where can you start?



# Common NFP governance gaps

## 4. Lack of clear delegations

- Appropriate delegations ensure correct decisions are made at the correct level
- Section 198D of *Corporations Act* – any power can be delegated (unless restricted by Constitution) – but the Board is responsible for it as if they had made the decision/taken the action.



# Common NFP governance gaps

## 5. Lack of internal controls

- Identified as a key fraud risk (Fraud Survey) – 79% of fraud is internal (*Community Directors Survey 2015*)
  - Estimates of NFP fraud - \$38 million across the sector but only 35% reported to police (*Community Directors Survey 2015*) or 46% (*Fraud Survey*)
  - Financial mismanagement a common reason for complaints to the ACNC (*ACNC Compliance Report*)
- Other types of controls outside financial management controls:
  - Policies
  - Position descriptions
  - Pre-employment screening

# Common NFP governance gaps

## 6. Poor performing Board

- Choosing your Board composition and skills matrix – the luxury of large organisations?
- Passion – yes. Required skills – no.
- Disengaged – lack of attendance and pre-preparation
- NFP directors receiving payment
  - around 15% (complexity of organisation, skill required and time spent identified as key factors )

# Do you need some help?

- Where do you start?
  - ACNC – many resources – factsheets, guides
  - AICD – Australian Institute of Company Directors Good Governance Principles and Guidance for Not-for-Profit Organisations and other resources free to access
  - Institute of Community Directors Australia – free resources including policies



# When do we need a lawyer?

- Risk management framework should flag these points – if a risk with significant impact arises - seek advice.
- Specialist NFP advice can cover:
  - Entity establishment advice
  - Advice on tax endorsements
  - Advice on terms of funding contracts
- NFP advice vs usual business advice - NFP's are businesses too:
  - Leases
  - Trademarks
  - Employment agreements/employee management (1.2 million staff just in charitable sector, according to *Charities Report*)
  - Joint venture agreements
  - The list goes on...

# Tips when engaging a lawyer

1. Finding the right lawyer
  - Do you need pro bono (no fee) assistance?
  - Ensure appropriate experience/expertise
2. Ensuring the scope of your instructions is clear
  - Provide full information and documents upfront
  - You can limit the scope to reduce costs

Any questions?

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