

THIRD *dimension*

A practical legal perspective for charities and not-for-profits

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Changing Climates For Not-For-Profits: Useful Guidance On How To Adapt

Making A Profit As A Not-For-Profit: Undertaking Commercial Activities

BY Elizabeth Lathlean, Associate



Whilst a not-for-profit does not operate for the profit or gain of its members, it is permitted to generate a profit in undertaking its activities, in line with its stated purposes.

With changing practices in giving and an increasing lack of certainty around regular funders, an increasing number of not-for-profits are looking to undertake commercial activities as a way of generating income, and enabling the continued provision of services.

Commercial activities are those activities involving transactions (sales and purchases at a fee), generally with the aim of providing goods and services to businesses and individuals.

A not-for-profit is permitted to engage in commercial activities, as long as those activities are undertaken with the aim of advancing the organisation's purposes (as outlined in its governing document). For a charity registered with the Australian Charities and Not-for-profits Commission, such charitable activities need to align with the organisation's charitable purpose(s).

For charities, there are four main ways they may carry out commercial activities in line with their charitable purposes. These are:

- (a) Commercial activities directly carrying out charitable purposes – where a charity carries out commercial activities as part of its charitable activities, and these activities directly relate to its charitable purposes;
- (b) Commercial surplus used to further charitable purposes – where a charity undertakes commercial activities with the aim of generating a surplus, which will fund its charitable activities;
- (c) Intrinsically charitable activities carried out in a commercial way – where a charity's activities are intrinsically charitable but carried out in a commercial way; and

- (d) Commercial activities incidental to charitable purposes
- where an organisation's commercial activities are only incidental to its primary stated purposes.

There are a number of factors to consider in determining whether it is appropriate to undertake commercial activities. Some of the main considerations are outlined below.

Step 1: Know Your Organisation's Purpose

Review the objects clause of your organisation's governing document and ensure it accurately reflects your organisation's purpose and activities.

It is common for organisations to depart from their originally determined path, and this often results in the objects, activities and operations practised by the organisation being out of sync with those stated in its governing document. Some key questions you should ask at this stage include:

- (a) What sort of activities does your organisation engage in?
- (b) Who are the members and / or beneficiaries of your organisation?
- (c) Does your organisation's objects clause accurately reflect these?

If no, your organisation may need to consider revising its governing document. If yes, proceed to Step 2.

Step 2: Different Commercial Legal Structures

There are a range of different options and legal structures that you can utilise to undertake commercial activities, in line with your stated purposes.

- (a) Consider entering into a collaborative arrangement with an existing organisation.

Some useful matters to consider include:

- i. Are there other organisations or businesses with a similar purpose and social concern?
 - ii. What products or services does your organisation rely on to survive?
 - iii. Would it be possible to enter into a collaborative arrangement with current suppliers?
 - iv. What can your organisation offer other businesses and / or organisations?
 - v. How can your organisation make the most out of a collaboration?
- (b) Consider integrating commercial activities into your organisation's current structure.

Some useful matters to consider include:

- i. Does your organisation already provide products or services to its members / beneficiaries?

“With the decline of the welfare state, charitable organisations are expected to do more with the same resources. Reliance on donations alone will, in many cases, be insufficient. Hence many charitable organisations have established business ventures to generate the income necessary to support their activities.”

Commissioner of Taxation of the Commonwealth of Australia v Word Investments Ltd [2008] HCA 55

- ii. Would it be possible to start charging for these products or services?
- iii. Would charging for these products or services compromise your organisation's patronage or membership?
- iv. What skills or expertise does your organisation already have?
- v. Is it possible to use these skills to start providing goods or services at a cost?
- vi. How can your organisation make the most out of its current structure?

- (c) Consider starting up a separate entity.

See questions above in relation to Step 2 (b). Some further matters to consider include:

- i. What type of legal entity should your organisation establish?
- ii. Will the new entity be a subsidiary company or a parent organisation?
- iii. What skills will be necessary to set up the new entity?
- iv. Can your organisation afford the start-up costs?
- v. What relationship will the new entity have with your current organisation?
- vi. What services or products will the new entity provide?

Social Enterprise: A Solution To Uncertain Times?

BY John Vaughan-Williams, Lawyer

Social enterprise is a quickly growing phenomenon in Australia, gaining particular momentum within the not-for-profit sector. This piece will set out the structural characteristics of social enterprise, examine its potential utility for the not-for-profit sector, and also detail some successful examples.

Australia has no set legal definition of a social enterprise, but generally it is defined as an organisation that:

- a) is driven by a public or community cause, whether that be social, environmental, cultural or economic;
- b) uses trade to fulfil its mission;
- c) obtains most of its income from trade, rather than donations; and
- d) applies the bulk of its profits towards its social mission.

Some nations do have specific legal corporate structures that are to be used by social enterprises such as the UK's Community Interest Company structure. In Australia, a social enterprise may adopt almost any legal structure, including that of a public company limited by guarantee, a public company limited by shares, an incorporated or unincorporated association or a co-operative.

Not-for-profit status

A social enterprise may either operate as a for-profit or not-for-profit, however many incorporate elements of both to achieve their mission. The functioning structure of a social enterprise will typically be a commercial trading branch of a charity, a community or member owned business, or a privately owned business designed to achieve a social, cultural or environmental aim.

Some social enterprises will adopt a for-profit structure, allowing them to seek investors to fundraise. Profits are partially distributed to investors, while the rest reverts to the social mission. This can be used, for instance, in social enterprises that serve to promote employment for the disadvantaged. While they achieve their social mission by operating a business that employs the disadvantaged,



some of the profits are paid back to shareholders as dividends.

Charity status

Social enterprises incorporate some characteristics that can be found in charitable organisations, but they have the following recognisable traits:

- a) they are connected to the open market, selling products and / or services to derive revenue, and they are strongly influenced by changes in the market;
- b) the goods and / or services sold may be aimed at different people from those they are trying to assist;
- c) they do not primarily rely on funding, donations or grants for income; and
- d) they use the same tools and expertise as their commercial competitors to run their organisation – they are commercialised.

A social enterprise may be eligible to be registered as a charity with the Australian Charities and Not-for-profits Commission (**ACNC**). However, this will depend on whether its aims meet the statutory purposes of a charity, including whether it operates as a not-for-profit.

Social enterprise within a charity

A social enterprise will sometimes be created as a branch of an existing charity, while not itself being a charity. An example of this is the chain of Big Heart retail shops, operated by Mission Australia (a charity registered with the ACNC). These retail shops are op-shops, which provide employment opportunities to the disadvantaged. The profits of these shops are put towards both the running of the shop and the community programs of Mission Australia.

When a charity wishes to operate a social enterprise as a branch, it may be eligible to receive certain government grants to be used for this purpose. If a charity wishes to incorporate a social enterprise within its existing structure and operations, it must ensure that this is consistent with its charitable purposes and also does not jeopardise its existing tax endorsements.

Utility of social enterprise for not-for-profit sector

In the current economic climate faced by the Australian not-for-profit sector, many organisations are considering structural changes, such as mergers for increased financial viability. The establishment of a social enterprise within a charity is one way to boost financial prosperity whilst retaining the charity's previous operations.

This strategy in essence creates an operational offshoot of the organisation, therefore reducing risk. Charity boards can be apprehensive about including trade in the organisation's structure, because of a perception that it will alter the organisation's fundamental brand and public perception. The benefit of this model, however, is that the social enterprise can be formed as a separate by-product of the charity operating under a different name, so that it does not interfere with the unique identity of the charity.

In order to do this successfully, the organisation should ensure that it has an adequate framework in place to support it, and that it will not involve an initial investment that is too risky.

Examples of social enterprises

(a) The Big Issue Magazine

The Big Issue Magazine is an independent magazine that is sold on the streets by homeless and disadvantaged people Australia-wide. The magazines are bought by the sellers from the producer and then sold at a profit, allowing them to gain employment and income. It remains a business for the producer, deriving income from trade, but this helps to address the social issue of unemployment for the disadvantaged.

(b) Fair Trade Coffee Company

The Fair Trade Coffee Company runs a fair trade exclusive café in Sydney. Fair trade is a global social movement that aims to alleviate poverty by promoting fair trading conditions and local sustainability in the developing world. By exclusively selling products that have this certification, the company promotes poverty reduction while still running a commercially sustainable business model. Profits from the company go to a parent company, Palms Australia, which is an organisation that places skilled international development volunteers around the world.

(c) Salvos Legal

Salvos Legal is a unique and dynamic law practice situated in New South Wales and Queensland, entirely operated by the Salvation Army. The practice is split into two legal practices (which are both separately registered public companies): Salvos Legal Ltd and Salvos Legal (Humanitarian) Ltd. The first of these practices is a commercial firm, advising and representing clients regarding such matters as corporate and commercial law, intellectual property law and conveyancing. All of the fees (less expenses) from this firm then fund the second law firm, which provides free-of-charge legal services to the disadvantaged.

(d) Cleanable

Cleanable is a cleaning company based in Melbourne that strives to provide employment to those who are otherwise unable to gain it due to mental illness. The company provides cleaning services across Melbourne, running under a viable business model with several major contracts. The company allocates a set proportion of employees to those who are otherwise unable to gain employment due to their disability.

Conclusion

The primary features identifying a social enterprise are that (a) it derives its income mainly from trade rather than donations; and (b) it is driven by a public or community cause.

A social enterprise may be a not-for-profit organisation, depending on how it applies its profits. It also may be a charity, if it is not-for-profit and its purposes meet the statutory definition of a charity. Meeting these requirements will allow the entity to gain registration with the ACNC. There is no clear distinction between a social enterprise and a not-for-profit organisation or charity, as a social enterprise may incorporate elements of either.

In the current economic climate, which has recently driven talks of change within the sector, the social enterprise is another structure that will likely be further explored, both within existing charities, and as new charities and not-for-profits are formed.

Is Ignorance Bliss? An Examination Of The Duty Of Care And Diligence

BY James Thomson, Lawyer, and Lily Zhang, Paralegal



It is a long standing principle under both the common law and legislation in Australia that directors and officers of a company must exercise a reasonable degree of care and diligence in carrying out their duties and exercising their powers.

Given the nature of not-for-profit and charitable organisations, many directors and officers will be engaged as volunteers on a part-time basis, often having little to do with the day to day running of the organisation. These non-executive directors might assume that because of their limited involvement, their duty of care and diligence is reduced proportionately.

This article examines whether this is the case at law, and what steps a director or officer can take to reduce the risk of a breach of the duty of care and diligence.

1. What is the duty?

Section 180(1) of the *Corporations Act 2001* (Cth) (**Corporations Act**) places an obligation on directors and officers of corporations to exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:

- (a) were a director or officer of the corporation in the corporation's circumstances; and
- (b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.

Whilst section 180(1) of the Corporations Act does not apply to charities registered with the Australian Charities and Not-for-profits Commission, a similar obligation is placed on those charitable organisations as part of Governance Standard 5, created by section 45.25(2) of the *Australian Charities and Not-for-profits Commission Regulation 2013* (Cth) (**ACNC Regulation**).

Further, section 39A(4) of the *Associations Incorporation Act 1985* (SA) applies to certain "prescribed" associations only and section 84 of the *Associations Incorporation Reform Act 2012* (Vic), contain similar duties.

Interestingly, section 180(1) of the Corporations Act applies to directors and officers of a corporation personally, whereas section 45.25(2) of the ACNC Regulation does not. Rather, that section requires a charitable organisation to ensure that its "responsible entities" exercise a degree of care and diligence. The term "responsible entities" essentially refers to those persons who are responsible for governing a charity. In the case of a company, this will be the company's directors, or in the case of an association, its committee members.

Often, charitable organisations will include provisions in their constitutions requiring directors or committee members to comply with Governance Standard 5. The constitution, being a contract between the organisation and its directors / committee members, is enforceable against those directors and committee members.

2. What does the duty require?

In essence, a director, officer or committee member (collectively referred to in this article as Responsible Person) should place themselves in a position so that they can properly guide and monitor management of the organisation, and make decisions using sound business judgment based on an appropriate degree of knowledge of the business of the organisation.

Determining whether a Responsible Person has breached their duty of care and diligence requires an examination of the Responsible Person's conduct in the context of the organisation's particular circumstances (as required by section 180(1)(a) of the Corporations Act).

Although the Court will view the circumstances of an organisation on a case by case basis, these circumstances might include, for example:

- (a) the size and nature of the organisation's business or operations;
- (b) the composition of the board of the organisation and the individual board members' experience and expertise;
- (c) the limitations of the organisation's financial and management reporting systems; and
- (d) the manner in which the responsibility for the business of the organisation is distributed between the Responsible Persons and employees.

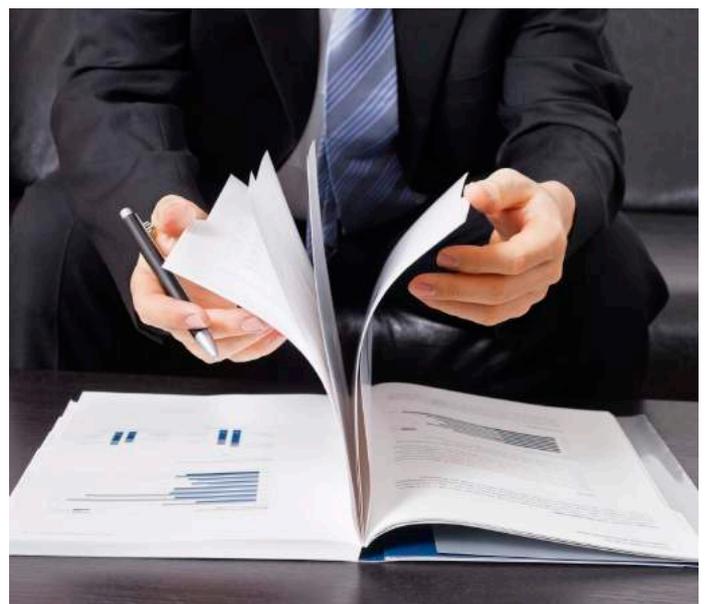
Section 180(1)(b) also requires the examination of the particular responsibilities that the Responsible Person is performing. The responsibilities placed on a Responsible Person will include those specifically created by statute, the organisation's constitution or a resolution of the organisation or otherwise (such as under a contract of employment of a non-executive director). Furthermore, responsibilities may be extended to include those flowing from a particular Responsible Person's experience and skills that they have brought to their office, even in the absence of a specific delegation of responsibility. For example, when examining the standard to be applied to an officer of an organisation, the Courts have previously held that a secretary who is also general counsel for an organisation is responsible for providing advice on compliance with all of the legal requirements relevant to the organisation.

Whilst not an exhaustive list, and noting that each case needs to be examined on its own particular facts, case law suggests that a Responsible Person may be seen to have breached their duty of care and diligence by:

- (a) failing to take reasonable steps to assess their organisation's financial position and performance;
- (b) failure to familiarise themselves with the fundamentals of the organisation's business and its operations;
- (c) failing to maintain cash reserves adequate to ensure that the organisation does not trade insolvently;
- (d) failing to ensure that sufficient meetings of Responsible Persons are held in order to facilitate proper management of the organisation;
- (e) failing to ensure proper financial statements and records are maintained;
- (f) entering into transactions that a Responsible Person acting with reasonable care and diligence would not have entered into; or
- (g) making misleading statements to members of the organisation or the public.

3. The Business Judgment Rule

Section 180(2) of the Corporations Act provides a business judgment rule, which acts as protection from liability under s 180(1) of the Corporations Act. It essentially exists to ensure that directors and officers are not discouraged from taking advantage of opportunities that involve responsible risk-taking. A similar protection is offered under regulation 45.110 of the ACNC Regulation, for Responsible Persons of registered charities.





The protection offered only applies to business judgements, meaning any decision to take, or not to take, action in respect of a matter relevant to the business operations of the organisation. Importantly, liability that arises from a failure to make a decision or lack of supervision does not fall within the scope of this rule.

Responsible Persons will have been taken to have met their duty of care and diligence, if the Responsible Person:

- (a) makes the relevant judgment in good faith for a proper purpose;
- (b) does not have a material personal interest in the subject matter of the judgement;
- (c) has informed themselves about the subject matter of the judgement to the extent they reasonably believe to be appropriate; and
- (d) rationally believes that the judgement is in the best interest of the organisation.

The burden of proof lies with the Responsible Person seeking to rely on the protection provided by the business judgment rule.

4. Practical steps to comply with the Business Judgment Rule

Whether or not the business judgment rule will be satisfied often turns upon the state of mind and conduct of the

Responsible Persons at the time that the decision was made. This means that documentary evidence can play a key role in raising a defence under the Business Judgment Rule.

4.1. Board Papers

Board papers are essentially information packages that assist the Responsible Persons of an organisation to make an informed decision on matters which are put before them. They are formal records of the information and advice on which the board relied in making its decision and, as such, are crucial pieces of evidence that can be used to demonstrate if a business judgment was reasonably informed.

Some useful tips for the preparation and use of board papers are as follows:

- (a) board papers should not be unnecessarily detailed, but should provide all the necessary information to ensure that the Responsible Persons are reasonably informed of the matters upon which they are to make a decision;
- (b) board papers should state their purpose clearly, for example, is a resolution proposed in respect of the subject matter of the paper, or is it presented for discussion purposes only;
- (c) if a resolution is proposed, then the board paper should clearly state the resolution and the risks of the alternative decisions open to the Responsible Persons. Where relevant, the recommendations of senior management should also be included;
- (d) board papers should be written in plain English, and should ideally follow a common form and structure;
- (e) board papers should be distributed among the Responsible Persons prior to the meeting, in order to allow them enough time to properly review and consider the paper; and
- (f) the organisation should keep copies of all board papers along with its minutes book for future reference.

Whilst creating board papers may be an administrative burden for smaller organisations with limited administrative resources, their importance cannot be understated when it comes to the decision making of an organisation's governing body. Not only do board papers assist Responsible Persons to make the decision that is in the best interests of the organisation, they can also help to protect the Responsible Persons from personal liability.

4.2 Minutes of Meeting

Along with board papers, board minutes are also extremely important records of the decision making process of Responsible Persons. In conjunction with board

papers, they provide a relatively complete picture of what information a Responsible Person has based their decision on, as well as the reasons for which a particular decision was made.

Generally speaking, two forms of minutes are utilised, as follows:

- (a) Minutes of Resolution - normally these minutes will principally contain the wording of the resolutions considered by the meeting, rather than also including a narrative on the background of the resolution, or the reasons upon which the decision was made; or
- (b) Minutes of Narration - these minutes are often much more comprehensive than minutes of resolution, and will usually contain details on discussions and reasoning surrounding a decision which is made.

Some useful tips for the preparation of minutes are as follows:

- (a) minutes should strike a balance between the minutes of resolution and the minutes of narration styles. They should not be a transcript of the meeting, but they should provide sufficient detail as to how and why a decision was reached, as well as why any alternative decisions were rejected;
- (b) if the reasons for a decision are clear from a board paper, then you may choose not to record the reasons in the minutes. However, if they differ from those stated in the board paper, then they should be included in the minutes;
- (c) any personal interests of Responsible Persons declared should be recorded in the minutes. If that person has excused themselves from the meeting, their absence should be recorded, as well as their return to the meeting (and the timing of each);
- (d) any significant issues or concerns raised by Responsible Persons, and the way in which they were resolved, should be recorded in the minutes; and
- (e) where action is needed as a result of a decision made at the meeting, the minutes should record who is responsible for that action, what is to be done and by when.

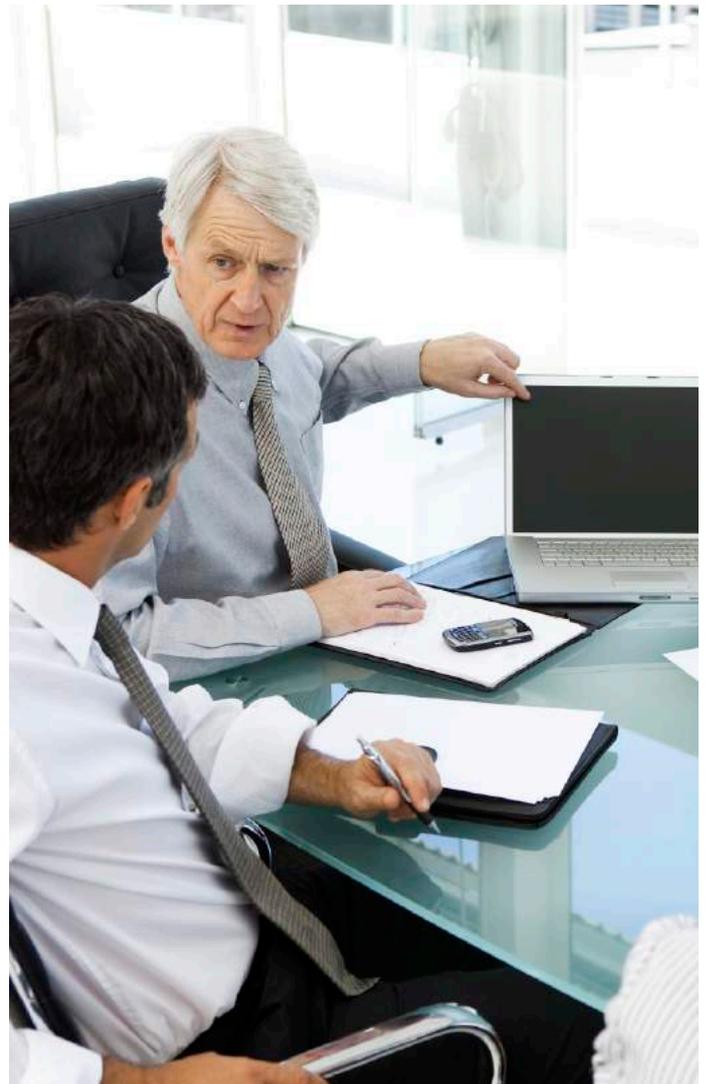
Minutes should be signed by the chairman of the meeting or of the next meeting, and entered into the organisation's minute books within one (1) month of the meeting. By virtue of section 251A(6) of the Corporations Act, such minutes properly entered will be prima facie evidence of what occurred at the meeting of a company. In respect of other organisations not covered by the Corporations Act, following the procedure set out in section 251A(6) of that Act is considered to be good governance regardless.

In any event, minutes should be prepared as soon as reasonably practicable after close of the meeting.

5. Conclusion

Responsible Persons are obligated to place themselves in a position that allows them to properly guide and monitor management of their organisation. They should ensure that decisions are made using sound business judgment and are based on an appropriate degree of knowledge of the business of the organisation.

It is acknowledged that the preparation of documents, such as board papers and minutes of meeting, can seem to be an administrative burden, especially for smaller organisations. However, they are imperative in demonstrating that decisions made by the Responsible Persons of an organisation were made properly, and with due care and diligence.



Annual Information Statements: What Does The Future Hold?

BY John Vaughan-Williams, Lawyer

The future of the Australian Charities and Not-for-profits Commission (**ACNC**) has been an uncertain and much debated topic in the entity's short lifespan, with the Coalition Government having moved to abolish it in 2014, shortly after its establishment in 2012.

Some level of comfort in its continued existence has since been provided through the suspension of the Bill moving its repeal, and the ACNC has also recently unveiled its plan for the next three years. Nonetheless, the future for the body remains somewhat unclear.

The then-Minister for Social Services, Scott Morrison, had announced in February 2015 that the abolition of the ACNC was not a priority in his portfolio, yet Social Services Minister Christian Porter stated in December 2015 that the Government was continuing to evaluate the ACNC and its role. In spite of this, only weeks later the Turnbull government proposed amendments to the way that ancillary funds will operate, and these amendments included new reference to the ACNC, providing some indication that the ACNC has a future.

This uncertainty has negated the clear, cohesive structure of charity regulation that the ACNC aimed to provide for the sector. As well as the degree of uncertainty regarding the ACNC's future existence, the ACNC has also proposed, and is currently considering, changes to the Annual Information Statement (**AIS**) that charities must submit.

This article will consider the AIS, possible changes to it, and what the future may hold for annual charity reporting.

Overview of Status Quo of AIS

All charities registered with the ACNC keep the public apprised of their operations through the submission of the AIS to the ACNC. The AIS can be viewed by potential donors and general supporters via the ACNC's public charity register (**ACNC Register**) (unless an exception applies for a particular charity).



The maintenance of the ACNC Register is a vital function of the ACNC, as there was no such central source of charitable information before the ACNC's formation in 2012. The increased transparency of charities, brought about by the Register, plays a key role in the object of maintaining, protecting and enhancing public trust and confidence in the Australian not-for-profit sector, an object of the statute establishing the ACNC.

With the importance of the Register in mind, it is imperative that the questions asked in the AIS provide an appropriate picture and level of detail about a charity's functions. In order to address this, the ACNC has proposed some changes to the AIS, and opened a public consultation for stakeholders, which closed on 27 November 2015.

The level and type of reporting that must be met by a charity in its AIS depends on its size, and which tier it falls in. The tiers are defined as the following:

- a) Small charities – charities with annual revenue of less than \$250,000;
- b) Medium charities – charities with annual revenue of \$250,000 or more but less than \$1 million; and
- c) Large charities – charities with annual revenue of \$1 million or more.

Medium charities and large charities must provide financial reports to the ACNC as part of the AIS. The report of a medium charity must be at least reviewed, and a large charity's report must be audited.

Small charities do not need their financial information to be audited or reviewed, but they must provide an income and balance sheet. Some charities are, however, exempt from providing financial information if they meet certain legislative exceptions.

The ACNC has reported in its quarterly publication of Spring 2015 that 99 per cent of registered charities completed their AIS in 2013, and 81 per cent completed theirs in 2014. As well as its utility in providing information to the public, the AIS also serves a function in addressing regulatory overlap. The ACNC's 'Charity Passport' is used for sharing information with other government departments, as part of its goal of a 'report once, use often' framework. Information provided in the AIS is used to form the Charity Passport - currently, only publicly available AIS information is shared, but the ACNC plans to use further AIS information in the Charity Passport in the future.

State jurisdictions are also working toward streamlining their reporting requirements with those of the ACNC, to reduce dual regulation. Victoria and Western Australia have both introduced bills to streamline financial report auditing with the ACNC's requirements, and South Australia has also made steps towards such a process. In addition to this, the ACT has announced intentions to amend its incorporated associations and charitable collections legislation, to harmonise with the ACNC.

If the AIS is to have such wide ranging use, it should incorporate questions that have support from both the sector and its regulators; this is a reason that the consultation process is important.

Possible Changes

The current consultation on the AIS is the first review of it as a whole, since its commencement in 2013. This period has allowed the review to be conducted in the context of both feedback from the sector, as well as gaps that the ACNC has identified in the AIS.

Some of the more significant proposed changes to the AIS include the following:

(a) Removing optional questions

Removing three previous optional questions, which pertained to reporting to other regulators, as this information has already provided a good statistical reference and is now believed by the ACNC to be unnecessary.

(b) Amending questions

The questions pertaining to the beneficiaries of the charity, and the types of activities the charity conducts, would be amended. Under the proposed new model, several

categories may be selected, to recognise the broad scope of activities undertaken by charities.

(c) Adding questions

Adding further questions regarding the finances of charities, in order to give a better picture of how a charity's funds are used, and what types of funds are received. This will also allow the ACNC to be more meticulous in its regulation.

One example provided by the ACNC of the utility of this extra information is identifying whether a charity has been involved with any related party transactions, through the additional financial questions. If a charity provides a financial benefit to a related party outside of its charitable purpose, it may no longer be eligible to maintain its charitable status.

Impact of Non-Compliance

Charities are expected to meet reporting obligations in order to uphold their charitable registration. If a charity does not complete its AIS following warnings, it will attract penalties and, if it continues, eventually lose its charitable status.

The due date of a charity's AIS will depend on its financial year - it will be due within six months of the end of the financial year. As a consequence of the due date varying across charities, it is imperative that charities be aware of when their Statements must be submitted, particularly in charities with numerous State branches that may have different financial years.

As well as a charity attracting penalties for not completing the AIS on time, its entry on the ACNC Register will publicly state that it has not been submitted. Given the ACNC Register is important in upholding public faith in the sector, this could have consequences for levels of community support for that charity.

In light of the significant ramifications of non-compliance, charities should ensure they keep abreast of any changes that are incorporated into the AIS, and continue to submit their Statements on time. Charities should bear in mind the requirements of the AIS throughout the yearly reporting period, and not only near the time the report is due. Having proper record keeping structures in place will help to ensure that accurate information is provided, and that the completion of the AIS is a less onerous task.

Directors' Rights: Moving Beyond The Call Of Duty

BY Elizabeth Lathlean, Associate



Directors of not-for-profit organisations are regularly encouraged to ensure they are aware of, and comply with, the duties and obligations required by the role. However, in addition to knowing what a director must do, and what a director is prohibited from doing, it is also important for a director to know what rights he or she has, and how those rights can be relied on and enforced.

Directors' rights are outlined in a variety of sources, including the organisation's constitution, under the *Corporations Act 2001* (Cth) (**Corporations Act**) (for public companies limited by guarantee), under the various State / Territory associations incorporation acts (for incorporated associations) and under the general law. Such rights allow directors to enforce the constitution, provide freedom for directors to participate in the decisions of the organisation and remain in office, and also ensure directors have access to the information and resources they need to efficiently and effectively carry out their valuable role.

The primary rights of a director of a not-for-profit organisation, and some suggestions regarding how to protect and enforce these rights, are set out below.

1. Right to enforce constitution

Section 140(1)(b) of the *Corporations Act* states that “[a] company’s constitution (if any) and any replaceable rules that apply to the company have effect as a contract ... between the company and each director and company secretary”. Similar provisions are contained in some State / Territory legislation for incorporated associations. For example, section 26(1) of the *Associations Incorporation Act 2009* (NSW) provides that “an association’s constitution binds the association and its members to the same extent as if it were a contract between them under which they each agree to observe its provisions.”

Whilst there has been an increasing trend for companies to enter into specific, individual contracts with directors, the absence of such contracts does not mean directors are disentitled to enforce their rights. Constitutional rights which may be important to individual directors include remuneration, indemnity and participation in board decisions.

2. Right to participate in board decisions

Directors generally have a right to participate in board decisions, including through receiving notice of board meetings, attending and voting at board meetings, and signing resolutions. The rights, and the mechanisms to ensure these rights are made available, are generally set out in the constitution.

Directors should be aware of the constitutional provisions regarding board meetings and decisions, and ensure any notice provisions are complied with. That being said, the constitution may provide that an accidental omission to send a notice of a meeting to a director, or the non-receipt of such notice, does not invalidate the proceedings of the board meeting, or any resolution passed at the meeting.

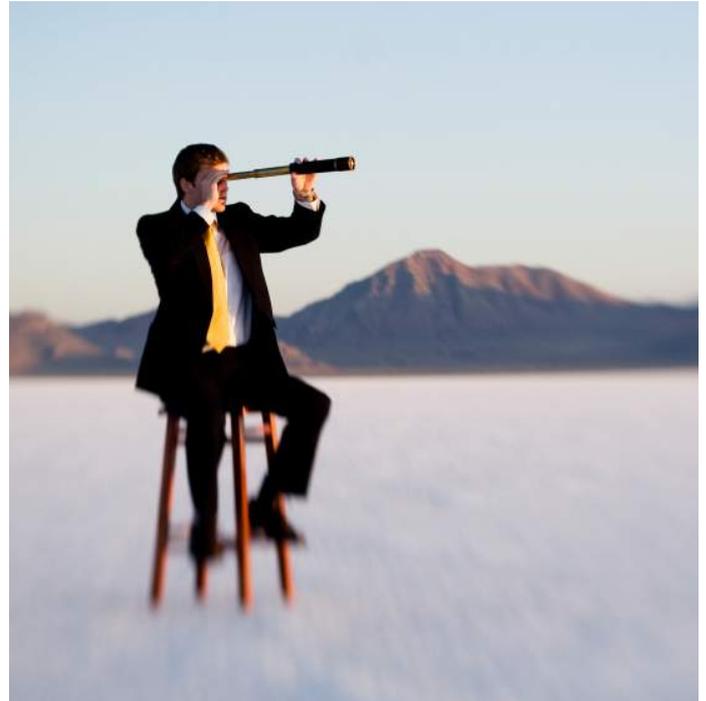
3. Right to remain in office until validly removed

The constitution will likely contain provisions permitting a director to resign, and circumstances in which a director may be validly removed, including upon the conclusion of his or her term (unless validly re-elected / reappointed).

In addition to any such constitutional provisions, section 203D of the Corporations Act provides that a director may be removed by ordinary resolution of the members. However, this is contingent on special notice being given and the other procedures required by section 203D of the Corporations Act being complied with. The requirements of this section cannot be overwritten by the constitution, and any non-compliance (including regarding the notice period and requirement to circulate a written statement) will likely result in any purported removal of a director being invalid. In some circumstances, failure to comply with certain provisions of the section may give rise to a criminal offence of strict liability.

Section 203E of the Corporations Act also provides a protection for directors to not be invalidly removed from office. The section provides that any notice, request or resolution of any or all of the directors that purports to remove a director from office is void.

Incorporated associations should consult their constitution and the applicable legislation in their State / Territory for the circumstances in which a director may be validly removed. For example, section 78 of the *Associations Incorporation Reform Act 2012* provides for certain circumstances in which a director (or committee member) may be removed from office, which includes by special resolution of the members. Removal of a director in these circumstances is unlikely to come with the same threshold of protection afforded to directors under the Corporations Act.



It is important for directors to be aware of their term of office, and the constitution and statutory situations in which they are able to be validly removed, before the conclusion of that term.

4. Right to access financial records and other corporate information

Directors have a right to access financial records and other information in the possession of the organisation regarding its affairs. In relation to this important right, the Court has stated:

"It would be difficult for the court to overemphasise the importance of the director's statutory and common law rights of access to corporate information. They are the foundation of the system of corporate governance as it exists in Australia today. Directors cannot be expected to carry out any of their substantial responsibilities ... unless they can be sure of having full and unfettered access to the documents of the company ... What should happen, when documents are demanded by a director, is that the gate is opened wide and the director has full and unfettered access at all reasonable times."

(*Fox v Gadsen* (2003) 46 ACSR 713)

Directors' rights of access include a right, provided certain criteria are met, to:

(a) access to the financial records at all reasonable times (s 290(1) Corporations Act); and

(b) inspect the books (but not the financial records, which is covered under (a)) for the purpose of legal proceedings (and extends the right to former directors who have ceased to hold office within the last seven years) (s 198F Corporations Act).

It is important for directors to understand the circumstances and scope of these rights, in relation to both the fulfilment of their duties and any potential or actual legal proceedings or disputes. Directors may wish to enter into a Deed of Access, Indemnity and Insurance with the organisation in order to confirm and protect the application of these rights (including a continuation of such rights after they cease to be a director).

5. Right to indemnity

A director may be entitled to be indemnified against losses and expenses properly incurred in the due performance of their duties. However, this right is subject to any contrary provision in the Corporations Act, applicable State / Territory legislation and the organisation's constitution.

The Corporations Act places certain limitations on the circumstances in which a company may indemnify its officers (including directors), or otherwise exempt them from liability. Similarly, State / Territory legislation for incorporated associations provides varying degrees of prescription regarding the circumstances in which a director may be indemnified. Despite such limitations, there is still scope for indemnity to be provided for directors.

In order to strengthen the protection of former directors (and other officers of the organisation), it is often advisable for directors to enter into a Deed of Access, Indemnity and Insurance with the organisation.

6. Right to access assistance and advice, including to engage external advisors, at the organisation's expense

There is currently no express statutory right for directors to access assistance and advice in relation to the discharge of their duties, at the organisation's expense. Such assistance, through proper procedures, may come from the organisation's officers, employees or external advisors.

Where such a right is desirable, it may be covered contractually, either in the constitution or through individual agreements between the organisation and each director.

7. Right to enforce statutory provisions

Directors, by virtue of their position, generally have no right to enforce provisions of the Corporations Act or other legislation. However, they may have such a right by virtue of other positions held, such as being a member of the organisation.

In addition to understanding their obligations, directors should ensure they are aware of their rights, under the constitution, the Corporations Act (for public companies limited by guarantee), applicable State / Territory associations incorporation legislation (for incorporated associations) and the general law. Organisations that are registered as charities with the ACNC should also consider any additional requirements that may arise from registration. Knowing about these rights, and the circumstances in which they can be relied on and enforced, is an important part of a director's role, and one that should not be overlooked.



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