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## Submission on modernising the Charities Act 2005

The Institute of Directors (IoD) appreciates the opportunity to comment on the Department of Internal Affairs' (the Department) [discussion document](#) on modernising the Charities Act 2005 (the Act). We welcome the discussion document which is the first public consultation on the Act in 14 years.

There are a number of other proposed changes for not-for-profits which we have also submitted on including the Trusts Bill, Te Ture Whenua Māori, incorporated societies and education reforms. Reform of the Act should take into account the wider not-for-profit reforms in New Zealand to ensure that there is cohesion across the sector. This reform will require not-for-profits to refocus their attention on their governance arrangements and what they are doing. This is a key opportunity for Charities Services to provide further education and guidance to charities.

Some stakeholders in the sector have called for a more comprehensive review of charities to be undertaken by the Law Commission and we encourage this. Notwithstanding, we view the discussion document as an opportunity to help raise the standards of governance in charities. Given the complexity of charities law and the diverse nature of the sector, we encourage the Department to continue to engage with key stakeholders in the sector and take sufficient time in assessing changes to ensure that there are no unintended consequences.

The IoD has significant expertise in charities and not-for-profit governance and we would welcome the opportunity to assist in the review.

Our submission focuses mainly on governance matters and, in particular, the questions around introducing governance standards. Notwithstanding our comments here, the IoD may make further and broader comments as the review progresses.

### [About the Institute of Directors](#)

The IoD is a non-partisan voluntary membership organisation committed to driving excellence in governance. We represent a diverse membership of over 9,000 members drawn from listed issuers, large private organisations, small and medium enterprises, state sector organisations, not-for-profits and charities. Fifty-one percent of our members have a not-for-profit governance role, and this is the main governance role for 25% of members.

Our Chartered Membership pathway aims to raise the bar for director professionalism in New Zealand, including through continuing professional development to support good governance.

### [Background and key challenges for charities](#)

The Charities Act provides a registration, reporting and monitoring system for over 27,000 charities in New Zealand. Charities spend around \$17b annually, manage \$58b in total assets, and are supported by more than 230,000 volunteers and 180,000 paid staff. We understand that 3.5% of

charities are companies, 25% are subject to the Incorporated Societies Act 1908, 38% are subject to the Charitable Trusts Act 1957, and most of the remaining charities are unincorporated societies and trusts. We also understand that New Zealand has significantly more charities per capita than other similar commonwealth countries such as Australia and Canada.

The not-for-profit sector has changed considerably over recent decades. The workload, level of responsibility, and skill and training required of volunteers and others working in the sector, has increased in conjunction with compliance obligations and public accountability. Other challenges include:

- intense competition for limited resources
- competing entities with similar services or scope
- attracting, motivating and retaining board members and staff
- securing reliable funding
- traditional reluctance to partner, enter joint ventures, collaborate or merge
- adapting to technological change.

The landscape in which charities are working is demanding and changing, and governance responsibilities and expectations have increased since the Act came into effect (eg around digital, cybersecurity, culture, social and environmental matters, health and safety, and the future of work).

A recent Charities Services' survey highlighted the following key challenges for boards and committees (beginning with the biggest challenges):

- obtaining funding
- strategic planning for the future of the charity
- identifying people with the right skill mix to come on boards
- compliance with requirements from government
- managing risk to the charity
- recruiting staff and managing volunteers
- understanding health and safety obligations
- difference between board's role and management/volunteers
- how to keep and report financial information
- how to run a meeting.

### Should New Zealand introduce governance standards?

In Australia, charities must meet core, minimum governance standards that essentially require them to remain charitable, operate lawfully, and to be run in an accountable manner. They are set out in law and are relatively high level, to ensure flexibility in compliance. The Australian charities regulator can take action against charities for breaching standards. The standards cover:

- purposes and not-for-profit nature of a registered entity
- accountability to members
- compliance with Australian laws
- suitability of board members
- duties of board members.

The Department asks whether governance standards would help charities to be more effective and whether the Australian standards could be adapted to work in New Zealand.

Good governance in charities is essential to their success. It can help address the challenges identified above and increase the likelihood that organisations will survive and fulfil their fundamental purposes. Other advantages include:

- providing organisational leadership
- ensuring accountability and transparency

- bringing depth and breadth of experience
- enabling better operational performance through better allocation of resources and better management
- contributing diverse views and reaching wise decisions
- managing risk and
- ensuring stakeholder relationships are managed.

It is critical that the standard of governance in not-for-profits is improved. Long overdue not-for-profit reform is imminent and this should help. Organisations that are impacted by reform will need support in transitioning and key stakeholders in the sector will need to take action to assist where possible.

New Zealand doesn't have governance standards or a code specifically for charities or not-for-profits and is out of step in this regard with other similar jurisdictions. However, there are several governance codes in New Zealand including:

- the IoD's [Code of Practice for Directors](#) relevant to all directors
- the Financial Markets Authority's [Corporate Governance in New Zealand: Principles and Guidelines](#) which is for entities involved in New Zealand's financial markets. While the code is applicable to not-for-profits, it's not prominent in the sector
- Sport New Zealand's [Governance Framework](#) for the sport and recreation sector and the associated Governance Mark.

We can see considerable benefit in introducing governance standards through a specific governance code for the charitable/not-for-profit sector that is fit for purpose and value adding to help raise the standard of governance. A key challenge will be to balance raising standards without burdening organisations and deterring people from getting involved in leadership. Rather than having legislative governance standards, we support the establishment of a voluntary governance code. This can provide flexibility and more comprehensive guidance (for instance through principles, recommendations, commentary and examples). It would be important to strongly promote take up of the code and charities that adhere to the code would have the considerable benefits of improved governance including through recognition from stakeholders (eg funders).

As part of assessing what would be most effective in New Zealand, we encourage the Department to consider the effectiveness of charity/not-for-profit governance standards/codes in similar jurisdictions overseas including those in the following table:

	<b>Governance standards/codes</b>	<b>Status</b>
<b>England and Wales</b>	<a href="#">Charity Governance Code</a>	Voluntary
<b>Scotland</b>	<a href="#">The Scottish Governance Code for the Third Sector</a>	Voluntary
<b>Ireland</b>	<a href="#">Charities Governance Code</a>	Mandatory
<b>South Africa</b>	<a href="#">King IV Report on Corporate Governance for South Africa</a> (this includes a supplement for non-profits) IoDSA	Apply and explain
<b>Australia</b>	<a href="#">ACNC Governance Standards</a>	Mandatory
	<a href="#">Not-For-Profit Governance Principles</a> (AICD)	Voluntary

Key considerations for a New Zealand code include whether it should:

- be solely for charities, or other not-for-profits and impact/purpose driven organisations and
- have differential requirements for large and small organisations (eg like in England and Wales).

A new governance code for charities and/or not-for-profits may be able to address some other issues set out in the discussion document for example, in relation to the accumulation of funds and managing conflicts of interest (discussed below).

### **Are limits needed around the accumulation of funds?**

Charities must use their funds for charitable purposes. The discussion document refers to private foundations accumulating significant funds and only making minimal distributions, and charities with businesses that apply minimal or no funds to charitable purposes.

The Charities Act does not limit the funds a charity can accumulate. Charities that are Tier 1-3 reporting entities have reporting requirements around the accumulation of funds. Tier 4 reporting entities do not need to report on the funds they have accumulated over their lives but must report on the amount of cash they have and other resources they own.

There are many legitimate reasons why charities need to accumulate funds (eg for a specific purpose such as investment in IT) and this can depend on the organisation (eg Māori and Iwi entities with long term horizons). It is essential that organisations retain sufficient funds to ensure that they remain solvent, and they need to consider the risk profile of their income and expenditure. For example, if revenue is variable/irregular, and costs are fixed, then they may need higher reserves. For these reasons, we do not support charities having to distribute a certain amount of funds each year. However, it is important that organisations are transparent about their strategy for accumulating funds and spending funds on charitable purposes (eg through a reserves policy and in their annual reports). Transparency and meaningful reporting is important to stakeholders and can help build trust and confidence in the charitable sector. Guidance about accumulation could form part of the governance code referred to above.

### **How should conflicts of interest be managed?**

The discussion document outlines a number of issues with charities that operate businesses to generate income for charitable purposes including related party transactions and conflicts of interests.

Charities are required to include related party transactions in their financial statements. However, the Charities Act does not indicate how officers must manage conflicts of interest. Charities Services may require a charity to take reasonable steps to address conflicts, such as having a robust conflicts of interest policy and rules expressly preventing officers from acting when conflicted.

The Department asks what should be the requirements of charities to manage conflicts of interest when undertaking business activities to essentially ensure that there is no private profit to individuals.

Conflicts of interest can be a commonly unidentified and overlooked risk for directors. They can be challenging to manage and can give rise to significant public scrutiny. Conflicts of interest disclosure rules are an essential part of any governance regime and they are important for maintaining trust and confidence in the sector. A key reason for having such rules is to provide a process to manage actual or potential conflicts and to ensure that decisions are made (and seen to be made) without bias and for the right reasons. We note that the draft Incorporated Societies Bill consulted on in 2016 includes rules to address conflicts (based on sections in the Companies Act 1993) and the Trusts Bill has a default duty to avoid conflicts of interest. We would welcome greater clarity for charities and consistency around conflicts of interests and this could form part of the governance

code referred to above. See also the IoD's [Conflicts of Interest Practice Guide](#) and the FMA Corporate Governance in New Zealand: Principles and Guidelines which covers conflicts.

### Should there be greater restrictions on who can be officers of charities?

The Charities Act defines the meaning of 'officer' for charities. In relation to the trustees of a trust, 'officer' means any of those trustees. In relation to any other entity, it means:

- a member of the board or governing body of the entity if it has a board or governing body or
- a person occupying a position in the entity that allows the person to exercise significant influence over the management or administration of the entity (eg a chief executive).

There are restrictions on who can be officers of charities, eg people are restricted if they have been convicted and sentenced for a crime involving dishonesty within the last seven years. However, the Charities Registration Board has discretion to waive a disqualifying factor for an officer.

The Department asks whether other people with convictions for serious offences (eg serious drug offences, murder, sexual offences) should also be disqualified from being officers. We consider that there needs to be more stringent requirements around who can be an officer of a charity given the potential to undermine public trust and confidence in the sector:

- **Serious offences:** Generally, people convicted of serious offences should be restricted from running charities (subject to limited exceptions). We encourage the Department to consider the experience of similar jurisdictions overseas in dealing with this issue (eg the United Kingdom)
- **Overseas bans:** The Department should consider disqualifying people who have been banned in governance roles overseas from being officers of charities. We note that this is something that the Ministry of Business, Innovation and Employment is considering in the context of companies. As a general principle, we believe it is inappropriate for an officer who has been banned overseas and who would have been banned from being an officer under New Zealand law to still be entitled to be an officer here. However, given the differences that exist between regimes, it is important to have mechanisms to address this (eg Charities Registration Board discretion)
- **Consistency:** *Where appropriate*, there should be a level of consistency in eligibility requirements for people in governance roles across all organisations in New Zealand (eg companies, charitable trusts, and incorporated societies).

### Is a new 'micro entity' reporting tier needed?

Charities have annual reporting obligations to Charities Services. Charities Services' data shows that many charities are not complying with minimum reporting requirements and especially Tier 4 charities (who must attach performance reports to their annual return). The discussion documents notes that some stakeholders have proposed that a new 'micro entity' reporting tier should be created for charities with \$10,000 or less operating expenditure under which they wouldn't need to comply with the current XRB reporting standards (eg they could just complete a fill-in-the-box financial statement).

We are concerned about the current non-compliance rates and especially for Tier 4 entities. We also expect that non-compliance will often be related to the time it takes to prepare reports and the capability of officers involved.

There are good reasons for the level of compliance in the current regime including the need for transparency and accountability for public funds. However, this needs to be balanced against other factors including the compliance time, cost, capability and risks to the sector. On balance, we consider that there is merit in creating a new reporting tier with simpler reporting requirements for the smallest charities.

## Conclusion

The IoD welcomes the discussion document on modernising the Act and we view this as an opportunity to help raise the standards of governance in charities. We can see considerable benefit in introducing governance standards through a specific governance code for the charitable/not-for-profit sector that is fit for purpose and value adding. A key challenge will be to balance raising standards without burdening organisations and deterring people from getting involved in leadership. We also support the Department looking at options to strengthen who can be officers of charities, and we consider that there is merit in creating a new reporting tier with simpler reporting requirements for the smallest charities.

We appreciate the opportunity to comment on behalf of our members and would be happy to discuss this submission with you.

Yours sincerely



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