Regulatory Impact Statement

A New Act for Incorporated Societies: Government response to the Law Commission's report

Agency Disclosure Statement

This RIS has been prepared by the Ministry of Business, Innovation and Employment. It relates to the Government's response to the Law Commission's report *A New Act for Incorporated Societies*, which was published in August 2013. The Commission's report proposes a new Act which will replace the Incorporated Societies Act 1908, which is significantly deficient in a number of respects, particularly in relation to governance and dispute resolution.

Limitations on the analysis undertaken

The nature and rigor of the analysis is limited by the need to rely on subjective judgment about the size of the potential impacts. That reliance arises because of the difficulties in reliably quantifying how changes either individually or as a whole translate into improved sector efficiency and effectiveness. Attempting to quantify many of the benefits in dollar terms could amount to little more than guesswork that could overstate the amount by hundreds of percent or understate it by amounts considerably in excess of 50 percent.

The largest individual constraint is the absence of aggregate information on the register of incorporated societies, either for all societies or particular subsets of societies. The register does not provide any aggregate information about societies' purposes, goals, activities, or size (using such metrics as annual revenue, annual expenditure, total surplus or deficit, total assets or human resources).

Much of the analysis is based on the well-established principle that the state plays a fundamental role in supporting efficient and effective private sector economic activity by promoting best governance practices, increasing the predictability of entities' economic interactions, providing core protections against the misuse of legal personality and limited liability, and reducing the cost of resolving disputes. We have supported that analysis with numbers, including ballpark figures, where reasonably reliable data are available.

We have not encountered any material constraints solely as a result of the analysis being carried out by the Law Commission rather than ourselves. Where there were gaps in the report, we were generally able to obtain satisfactory additional information from the Law Commission, such as copies of submissions on its 2011 discussion paper and other information they had obtained in the course of their review.

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Introduction

1 This RIS considers whether the Government:

a. should broadly accept the Law Commission's report *A New Act for Incorporated Societies*, in particular whether a new Act should replace the Incorporated Societies Act 1908 (IS Act 1908) and an exposure draft be released to this effect; and

b. should accept or reject the Commissions individual recommendations, and include them in the exposure draft.

2 There is a glossary at the back of this RIS.

Status Quo and Problem Definition

Background

3 The Minister of Justice made a referral on 1 July 2010 asking the Law Commission to review incorporated societies law. The Commission's report, *A New Act for Incorporated Societies*, was published on 21 August 2013. The Government is required to respond within 120 working days under Cabinet Office Circular CO (09) 01, which is 4 March 2014. CO (09) 01 states that the Government will determine its position on Commission reports on government references by considering a Cabinet paper submitted by the relevant portfolio Minister. It also states that the Minister will submit the paper to a cabinet committee seeking Cabinet's approval of the recommendations in the Commission report to the extent that the Minister considers appropriate.

4 The Government must now determine whether it should broadly accept the Commission's report and, if so, which of the Commission's recommendations it should accept or reject. Other than the requirement to respond, the Government has complete discretion regarding how it does so.

Current law

5 The law of incorporated societies is not found in a single place.

6 Some of the law appears in the IS Act 1908. The IS Act 1908 provides for the incorporation of societies which are not established for the purposes of pecuniary gain. Incorporation also means that there is limited liability. Section 6 lists 12 matters that must be addressed in the rules of a society. Section 13 provides for limited liability, section 14 states that members have no rights to the property of a society and section 15 provides for societies to enter into contracts. The rest of the IS Act 1908 addresses such matters as the process for applying for registration, a prohibition on carrying on operations outside the scope of the society's objects, keeping a register of members, financial reporting, compromises with creditors and members, liquidating a society, rules on dividing surplus assets on winding up, dissolution by the Registrar of Incorporated Societies and the Registrar's investigation and inspection powers.

7 The Incorporated Societies Regulations 1979 prescribe the contents of the register, prescribe forms and provide for the payment of fees.

8 The IS Act 1908 is silent on a number of important issues, and case law addresses some of the gaps. In particular, case law:

a. Imposes certain duties on those governing or running incorporated societies. Those duties are similar to directors' duties that appear in Part 8 of the Companies Act 1993.

b. Obliges societies to resolve or participate in the resolution of disputes or grievances that arise within their society.

9 However, there have been few cases involving incorporated societies. Consequently, the case law is well short of being fully developed (e.g. in relation to the extent of conflict of interest-related obligations), which means that there are many uncertainties about what societies need to do to comply with the law.

10 There was a strong theme in the 200 or so submissions made to the Commission that the IS Act 1908 does not adequately support or promote good society governance practice because it is incomplete, inaccessible and unclear. This in turn means that many of the 23,500 or so societies registered under the IS Act 1908 are not operated in accordance with modern governance principles and practices, and committees are not sufficiently accountable to members for the effective and efficient stewardship of the resources under their control.

11 In order to promote good performance, incorporated societies need to know what the minimum standards are for running and governing societies. Committee members need to know what they can, must and must not do. Members need to know what information they can expect from their committee and what happens if they are involved in a dispute with the society or another member. None of these topics is covered in the IS Act 1908. The Commission found that this lack of guidance adversely affects the performance of a large number of incorporated societies.

12 The main policy problems resulting from the IS Act are addressed in Section 1 of this RIS. The more specific problems are discussed in Section 2.

Objectives

13 The main objectives are to consider whether the Commission has:

a. Correctly specified the problems associated with the status quo

b. Considered a range of feasible options for each problem

c. Assessed the options against appropriate criteria

d. Taken account of feedback in reaching its recommendations

e. Considered the impacts and whether the recommendation delivers the greatest net benefit.

14 We cannot make those assessments in isolation of the public policy objective, which is to have modern intelligible accessible workable enduring legislation that is fully consistent with incorporated society, governance and legislative principles. The Commission's report states that the following principles represent the overriding messages they received time and again in their consultation meetings and from submitters:

a. Societies are organisations run by their members. This means that members have primary responsibility for holding societies to account, and that a group without members to hold it to account should consider an alternative form of incorporation.

b. Societies should not distribute profits or financial benefits directly to members. This is one of the key features that sets incorporated societies apart from other forms of incorporation. People join societies to achieve a shared purpose, not to personally profit financially from the activities of the society.

c. Societies are private bodies that should be self-governing and largely free from unnecessary state interference. Societies value the flexibility that the current regime gives them to adapt their operating environment to suit their purposes and their culture. That flexibility should be retained as much as possible.

Regulatory Impact Analysis

Section 1: Broad Recommendation

15 The following paragraph from the report summarises the Commission's main conclusions:

> While the 1908 Act was innovative and world leading when it was enacted, the passage of time and developments in the New Zealand community have left it significantly deficient in a number of respects. In particular, it lacks guidance about the obligations of those running societies and about how disputes should be dealt with. There is a strong need to provide a more modern statute to guide this sector into the future. Such a statute will make societies more robust, will help them govern themselves, and will provide more constructive options when things go wrong.

16 The Commission's conclusion that extensive reform is needed has led to a recommendation that the IS Act 1908 should be replaced by a new IS Act.

17 We consider that the Commission's report fully bears that conclusion out. It is evident that the current law of incorporated societies is incomplete, inaccessible and unclear in many respects, particularly in relation to constitutional matters (including governance, rights and obligations) and internal dispute resolution. This situation leads to uncertainty about what societies, and their officers and members need to do to comply with the law. Although some societies can operate successfully without having this knowledge, it also means that:

a. many societies unknowingly act unlawfully, including in ways that are inconsistent with the democratic underpinnings of society legislation.

b. when problems arise the issue may not be satisfactorily resolved, or legal advice may need to be obtained. Occasionally there is expensive, acrimonious and drawn out litigation.

18 The main public policy problems are elaborated on in several submissions made to the Commission:

- The Auckland District Law Society (ADLS) stated that the IS Act 1908 falls significantly short when questions are raised about governance, rights and obligations.

- The New Zealand Law Society (NZLS) stated that the IS Act 1908 is now seriously out-of-date and no longer provides an adequate and robust modern statutory framework for incorporated societies. The NZLS also stated that lawyers advising community organisations and their members find little guidance in or assistance from the current legislation and the often inadequate constitutions of those organisations.

- Hesketh Henry agreed that the IS Act 1908 is uncomfortably old and that difficult questions often arise for those administering incorporated societies, and their advisers, relating to the governance and administration of such organisations and the resolution of disputes.

- Social Development Partners stated that people are often elected onto committees without having a clear understanding of the 'ownership' type responsibilities for the organisation.

- Hayes Knight Audit stated that they have experienced instances of organisations adversely impacted due to poor governance which has been aided and abetted by the IS Act 1908, especially as regards governance capture by a small number of individuals. Hayes Knight also stated that they have seen many instances where incorporated societies have got themselves into serious financial difficulties or have been subject to financial mismanagement or even fraud, due to a lack of appropriate accounting disciplines.

19 We also conclude that there is broad support in the sector for legislative reforms. This is evident from the information included throughout the report on submissions and other consultative processes undertaken by the Commission. This conclusion is also supported by the following commentaries published shortly after the Law Commission's report was published:

- The author of the reference book *Law of Societies in New Zealand*, Mark von Dadelszen states that "the current statute is in desperate need of a legislative overhaul, and the sooner the better, as societies and their members are ill-served by the present 105 year old legislation. In general terms, I support the Law Commission's reform proposals. While the details can (and will, and should) be debated, the Commission's approach is principled and moderate."[1]

- Hayes Knight describes the proposed reforms as "sensible and well-considered… If enacted [the recommendations] will help codify in law what is best practice for operating an incorporated society as well as provide greater clarity and protection for members."[2]

20 Although there are no indications in the report that the Commission considered amending the IS Act 1908, we consider that there was no reason for the Commission to do so because it is not a feasible option. The proposed reforms are extensive and the structure of the IS Act 1908 does not provide a sound platform for enacting those reforms. The objective of enacting intelligible accessible workable legislation will be better served by starting afresh.

21 The draft government response also states that an exposure draft (ED) of the Bill and a model constitution be released for public comment. This will be an effective way of testing the detail contained in many of the Commission's 102 recommendations.

Section 2: Individual Recommendations

22 This section assesses the key individual recommendations by the Law Commission, and considers whether or not to include them in the ED fully or largely in accordance with the Commission's detailed recommendations. Further regulatory impact analysis will be completed after submissions are received as a basis for the Government deciding what changes are to be made for the purposes of finalising the Bill for introduction into the House. However, releasing the ED does limit the ability of stakeholders to give a broad response, necessitating analysis of the Law Commission's recommendations at this stage.

Monetary gain (recommendations 4 and 99-102)

23 The Commission has identified two problems with the current law relating to the principle that Societies should not distribute profits or financial benefits directly to members.

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[1] Von Dadelszen, Mark – *NZLawyer* magazine, Issue 216, pp10-11, 6 September 2013.
[2] Hayes Knight News – Not-for-Profit, *Incorporated Societies Act – Time for an overhaul*, 27 August 2013, http://www.hayesknight.co.nz/home/news/news-items/2013/8/27/incorporated-societies-act-time-for-an-overhaul.aspx?tag=1402

24 First, several stakeholders expressed concern to the Commission that the monetary gain prohibition in the IS Act 1908 was not sufficiently clear about whether certain transactions are lawful. The Commission has recommended that a safe harbour provision be included in the new Act in relation to six specific matters.

25 We consider that the fact that some stakeholders have said that they have uncertainties is good evidence that the current law is inhibiting lawful conduct and that the Commission has correctly specified the problem. We also consider that the Commission's approach of only identifying the one option was appropriate. It might be argued that reliance could be placed on case law developments to fill the gaps. However, this is not a plausible option because so few cases are decided by the courts. Past experience would suggest that it would take several decades to get to anything like a clear set of case law principles on this matter. We conclude, therefore, that the Commission's analysis of this issue is very sound.

26 We would expect any issues relating to the details of the proposed safe harbour provisions would be identified during the ED process.

27 The second monetary gain issue relates to another provision in the IR Act 1908 that requires societies to have a rule on the disposition of property in the event of the society being put into liquidation. It does not place any limits upon the content of the rule. This creates the potential for distributions to members. The Commission noted that this rule is inconsistent with the 'no monetary gain' principle. The Commission also notes that there is nothing to prevent an incorporated society which is a registered charity from accumulating substantial surpluses, leaving the Charities Act regime and then changing its rules merely to allow distribution to members.

28 The Commission considered whether the new Act should retain the status quo or prohibit this type of monetary gain. The Commission recommended that they be prohibited.

29 The Commission did not attempt to find out exactly how many societies have rules that provide for distribution to members on liquidation because it would have required a manual search of all 23,600 societies on the register. However, samples examined by the Commission among chartered clubs indicate that such provisions do exist but they are likely to be rare. More common are rules that leave distribution to be determined by a final annual meeting, creating the risk that assets could be distributed to members. Such clubs may have accumulated significant assets but potentially face declining membership. This phenomenon is not limited to this type of club. However, clauses permitting or directing distribution to members still appear to be the exception not the rule.

30 The Commission has recommended that the new Act:

a. require every society's constitution to provide a rule nominating an NFP entity or class of entity to which the assets will be distributed on dissolution

b. include a transitional period for societies with express rules providing for distribution to individual members on dissolution or liquidation to change their rules.

31 We consider that the Commission's impact analysis is sound. The current rule is inconsistent with the monetary gain principle and there are no pragmatic reasons for retaining the unprincipled position.

32 This change is unlikely to change the conduct of the vast majority of societies. However, as illustrated by a court case in 2007 involving the Whangarei Hearing Association and current proceedings relating to the Otago Bowling Club, large amounts of money can be involved and serious issues can arise when officers of societies seek to use their positions for monetary gain.

33 The compliance costs associated with some societies having to replace or add a provision to their constitutions are likely to be insignificant, particularly if they adopt the model constitution (see paragraphs 98-107 below).

Membership requirements (recommendations 5 & 6)

34 The IS Act 1908 imposes a minimum 15 member requirement upon registration. The IS Act 1908 does not specify any automatic or mandatory consequence if a society later falls to fewer than 15 members, but it does state that the High Court may appoint a liquidator on the application of a member, creditor or the Registrar if membership is less than 15.

35 The Commission assessed this rule against the principle that an incorporated society is a group of persons who choose to associate together for a lawful purpose. The Commission reached two main conclusions:

a. The principle that incorporated societies are membership-based organisations remains important once a society has been incorporated and commences operating.

b. The current 15 member minimum is higher than necessary to protect the membership-basis principle. The Commission recommends that the maximum be reduced to 10 and that a new requirement be added that societies be required to continue to have at least 10 members. The Commission states that this strikes a balance between increased flexibility for small sport and hobby societies as well as social service organisations, while ensuring that incorporated societies remain membership-based.

36 We consider that the Commission has correctly specified the problem and used an appropriate framework for analysing it. There is no explicit statement in the report that other minima adjacent to 10 were considered. However the Commission has advised us that it considered other options ranging from as low as 5 to the current 15. Therefore, we conclude that the Commission did consider the range of feasible options. If there is a problem with 10, then we would expect that it would become clear during the ED process.

37 This change will facilitate more societies becoming registered, although we would not expect the increase to be large. There are no compliance costs.

Names of societies (recommendation 7)

38 The IS Act 1908 prohibits names of societies that would contravene an enactment, are identical or nearly identical to another society's name, or are undesirable. Those provisions are similar to the naming restrictions in the Companies Act 1993 (see Table 1). The Commission stated that there was no evidence of societies frequently being in conflict over names or having to spend significant effort obtaining or retaining rights to names.

Table 1: Restrictions on names

Incorporated Societies Act 1908	**Companies Act 1993**
"identical" or "so nearly resembles the name [of a registered society] as to be calculated to deceive"	"identical or almost identical"
"registration of the proposed name would be contrary to the public interest" or "undesirable"	"offensive"

39 The Commission considered the options of retaining the IS Act 1908 rules or adopting the Companies Act rules. Consistent with the majority of submitters who responded on this issue, the Commission has recommended the adoption of the Companies Act rules. The Commission notes that the Companies Act provisions provide a much simpler, more predictable and more efficient basis for decision-making. For example, it means that the Registrar does not need to make judgments about whether there is an intention to deceive.

40 We consider that the Commission has identified the feasible options, has assessed them against appropriate governance and law enforcement principles, and reached a conclusion that is supported by the analysis. Disputes concerning society names do not arise frequently. Nevertheless, it is clear that this change will produce net benefits because the Registrar will need to spend less time applying the simpler Companies Act rules.

Branch societies (recommendations 8-12)

41 The Incorporated Societies Amendment Act 1920 provides that branch societies or groups of branch societies may be incorporated by registered parent entities. The Court of Appeal has ruled that branches are autonomous because they have separate corporate personality. The District Court has set out key principles including that members of branches are automatically members of the parent body, creating dual membership. The Commission states that there are at least several hundred entities incorporated as branches.

42 The Commission stated that most branches are operating successfully, and have resolved for themselves issues relating to dual membership and potential inconsistency between a society and branch rules. However, the Commission also noted that the current legislative scheme may lead to disputes between societies and branches, or lead to relationships and administrative arrangements that neither the society nor the branch is satisfied with. For example, there have been cases of friction where a bequest or a donation was intended for a branch but was instead brought into the national organisation.

43 Just under a half the submitters who responded thought that there were problems with the branch provisions. Some considered that they were outmoded, too top-down and inflexible. However, a small number saw a need for strong central control, with branches clearly being subsidiaries of the parent.

44 The Commission considered whether to retain or remove the branch society option. The Commission concluded that this option is not needed because groups wanting to set up a national organisation and branch structure can instead arrange to incorporate as many societies as needed for their branch structure. It recommended that there should be no separate provision for branch registration under the new Act.

45 The Commission also considered whether currently registered branches should be grand-parented or required to re-register as a society. It concluded that they should be grand-parented because most branches are operating successfully.

46 We consider that the Commission has correctly specified the problem and identified the feasible options. We are also satisfied that the Commission's recommendations deliver the greatest net benefit. Requiring existing branches to reregister as stand-alone entities would impose compliance costs on the branches without a material countervailing benefit. Continuing to permit branch registration when there is no reason to permit it will make the new Act unnecessarily complex.

The legal dealings of an incorporated society (recommendations 13-17)

47 The Commission identifies a problem that is common to three issues relating to the legal dealings of an incorporated society. The issues relate to:

a. whether a society can indemnify its members who act in good faith in pursuance of the purposes of the society

b. whether a society has full capacity to carry on or undertake any business activity do any act or enter any transaction

c. whether the act of a society is invalid merely because the society did not have the capacity, right or power to do the act.

48 The common problem is that there is considerable uncertainty about whether these forms of conduct are lawful or unlawful because the IS Act 1908 says nothing about these matters, and case law is either incomplete or non-existent. Issue (c) also raises concerns about third parties being treated unfairly.

49 Most stakeholders who submitted on these points agreed that there are problems in these areas. The Commission considered both overseas legislation and Companies Act replication options. It has recommended that provisions modelled on the Companies Act be included in the new Act, in one case supplementing it with a more detail from the British Columbia Societies Act 1996.

50 We are satisfied that the Commission has correctly specified the problems and identified the feasible options. The Companies Act is the most obvious place to look to solve problems of this nature and they should be adopted unless it has been demonstrated that those provisions are faulty. This is not the case. There may be some debate about whether some of the detail is precisely right, but that can be tested during the ED process.

51 It is difficult to know how large the impact of these changes will be because it is not known how many societies are currently doing things that will be unlawful or not doing things because they do not know whether the conduct is lawful. However, it is clear that these clarifications will be of net benefit because:

a. they will remove unnecessary legal risks for societies, and their officers, members and creditors

b. they will reduce the risks of disputes, both internal and between societies and third parties.

Security for costs (recommendation 18)

52 The IS Act 1908 empowers the courts to require sufficient security to be given for costs where there is reason to believe that the assets of a plaintiff society will be insufficient to meet cost awards should the defendant win. Most other statutes providing for incorporation do not have an equivalent provision. The Commission considered the options of retaining or repealing the provision.

53 The Commission notes that this matter was raised in only one submission. The tenor of the submission was that judges do not often award security of costs because of public interest concerns and hence any costs awarded to a successful party at the end of the proceedings are valueless. The Commission did not draw any conclusions about whether the IS Act 1908 provision is or is not a good rule. It instead recommended that the provision in the IS Act 1908 should not be carried over into the new Act because civil procedure rules are the appropriate place to deal with this matter, not an Incorporated Societies Act.

54 We consider that the Commission's analysis is correct in all respects. The focus should be on the impact across all civil litigation, not merely the impact in the very small proportion of civil cases in which an incorporated society happens to be the plaintiff.

Committees (recommendations 19-20)

55 The purpose of a committee is to govern an incorporated society. This governance role includes exercising rights and discharging statutory and other obligations.

56 The Commission considered whether societies should be required to have committees. Most submitters acknowledged that clearly defined governance structures, clear roles for officers and processes that support good governance are advantageous to societies. Nevertheless, more than half of the submitters who considered this issue considered that requiring committees was too prescriptive and argued that societies are best able to determine their structures.

57 The Commission did not support the majority view. The Commission instead noted that all societies need to have some form of committee to make decisions and run its affairs. The Commission also recommended that the new Act should require that the constitution of the society should contain rules that set out the composition, roles and functions of the committee on such matters as the terms of office of committee members, qualifications for appointment and grounds for removal from office.

58 We consider that the Commission's analysis is correct in all respects. The Commission has correctly used governance principles for analysing this issue. There are obvious benefits to societies, their members and those who transact with them if there are formalities associated with the appointment, functioning and dissolution of committees which make it clear who has the authority for governance on behalf of the society. The ED process will test whether all of the detail proposed by the Commission is fully appropriate.

59 Implementing this recommendation is unlikely to affect most incorporated societies because they already have committee-related rules that are consistent with the Commission's recommendations. However, the impact can be serious for individual societies that do not have adequate rules related to these matters because lengthy and acrimonious disputes can arise.

Statutory officer (recommendations 21-26)

60 The Commission has considered whether there should be a requirement to have a statutory officer to facilitate communication between the Registrar and the incorporated society. There is no such requirement at present. The problem is that the Registrar finds it very difficult at times to be able to contact a person within a society who has governance responsibilities. The reasons that Registries staff need to contact societies include:

a. Making enquiries about an alleged monetary gain

b. Making enquiries where it is alleged that a society may be operating beyond the scope of its objectives

c. Sending a reminder letter requesting that financial statements be filed

d. In connection with a change of name

e. Checking registered office details.

61 In addition, the Commission received advice from the Registrar that up to 200 societies are dissolved each year for apparently having ceased operations. This step only occurs after the Registrar has made three attempts to contact the society with a reminder and warning notices. While the majority of such societies have ceased operating, a steady trickle of applications for revocation of dissolution demonstrates that for a significant minority the apparent cessation of operations actually only amounts to a failure to communicate and a lack of sufficient order in society administration.

62 The Commission considered whether to retain the status quo or introduce a requirement for every incorporated society to have a statutory officer at all times The Commission agreed with the approximately three-quarters of submitters who considered that there should be a statutory officer, responsible for interaction with government.

63 A minority of submitters suggested that there should be no statutory prescription regarding officers. Some of those submitters stated that the current requirement in section 6 of the IS Act that the constitution must provide for appointment of officers, is enough. Others stated that there should be no mandatory rules, but a model constitution could provide guidance on what officers to appoint.

64 We consider that the Commission's analysis is correct in all respects. Merely leaving it to individual societies to decide whether to have a statutory officer fails to address the problem because the Registrar will continue to find it difficult to contact many societies when this is needed for regulatory purposes. In addition, the compliance costs are negligible. Most societies already need to appoint several officers at their annual general meeting (typically a minimum of the president, secretary, treasurer, and committee members). One extra officer vote will be insignificant, particularly given the likelihood that the secretary or another office holder will be elected in most cases.

Officers' duties (recommendations 27-33)

65 The IS Act 1908 provides that a society's constitution must prescribe how officers are appointed. However, there are no provisions dealing with the obligations of officers once appointed. Although the IS Act 1908 is silent on such matters, there is important case law. Among other things, case law requires officers to act in the interests of the society and prohibits using a committee position or office for personal advantage. Case law has also addressed such matters as conflicts of interest.

66 The Commission notes that officers probably owe similar fiduciary duties to their society as company directors do under the directors' duties provisions that are comprehensively described in the Companies Act. The other duties in the Companies Act include a duty to exercise powers for a proper purpose, comply with the Companies Act and the company's constitution, and avoid reckless trading.

67 The problem that the Commission identifies is that because the duties are not found in the Act, they are not clearly understood or accessible. The submission by the Charities Commission said that it had seen numerous examples of individuals involved in governance who appear to have little understanding of their duties.

68 The Commission notes that officers of societies are faced with both a shortage, and a bewildering array of sources to consult. There are only a very small number of New Zealand cases that deal with whether, to what extent and for which duties officers of societies owe fiduciary obligations to their societies. The precedent cases establish that officers are or can be fiduciaries, depending on the facts. For further guidance officers are left to infer what duties may apply to them and how from the rules applied to other fiduciaries, in particular company directors. Clubs Inc said that including a code of duties in the new Act would provide guidance and act as a reference point for committee members.

69 The Commission also notes that old equitable rules still apply because the equitable duties of officers and the legal consequences of breach have not been defined in statute. This means that a society may be able to avoid an obligation (e.g. a contract agreed with an innocent third party) simply because of their own officer's breach. This anomalous situation has long been resolved for companies by statutory amendment, but remains an issue for societies.

70 The Commission considered whether to retain the status quo or distil the general principles from cases and express them in statute and add the Companies Act provisions that relate to exclusion clauses and indemnities. Consistent with the views of most submitters, the Commission has recommended the latter option.

71 We consider that the Commission's analysis is correct in all respects. Legal clarity principles point to there being a compelling case for making the law clear and accessible to increase the likelihood that the duties will be complied with and improve governance performance. Any issues with the Commission's detailed proposals should become evident during the ED process.

72 This is one of the most important set of recommendations in the report. It is clear from submissions and other Commission stakeholder engagement that there are widespread contraventions of officers' duties, much of it due to ignorance of the law. Including a clear set of duties in the new IS Act will reduce the risks and provide a clear framework for resolving disputes in relation to alleged contraventions.

Conflicts of interest (recommendations 34-42)

Statutory conflict of interest rules

73 A conflict of interest occurs when a board member's duty of loyalty to an organisation comes into conflict with a competing financial or personal interest that he, she or a relative may have in a proposed transaction. Unlike later incorporation statutes, the IS Act 1908 provides no framework for managing conflicts of interest.

74 The Commission concluded that the rules for dealing with conflict of interest are an essential part of any governance regime for bodies corporate. It considered two options:

- To have an express statutory provision that sets a minimum requirement.
- To require societies to address the issue in their rules or constitution.

75 The Commission noted that the vast majority of submitters who expressed a view on this issue agreed that conflict of interest rules ought to be part of the new statutory regime. Many submitters also said that clear rules would assist societies who currently struggle to manage conflict of interest problems. The Commission agreed, stating that the express statutory provision option is transparent and educative.

76 We consider that the Commission's analysis is correct in all respects. There are no cases where it is acceptable for an officer to place a financial interest ahead of the interests of the society without disclosing the conflict. Hence, the option of leaving it to individual societies to make their own rules, including rules which may conflict with conflict-of-interest principles, is clearly inferior to the option of including it in the statutory regime. More specific matters, such as the Commission's recommendations on defining the scope of "interest" and how to address conflicts of interest can be fully tested during the ED process.

77 This set of recommendations is important because it has the potential to impact materially on a large number of incorporated societies. As the Commission notes, rules for dealing with conflicts of interest may be even more important for bodies incorporating under NFP legislation because a range of interests bring the members together and proper management of conflicts in respect of these shared interests is consequentially essential. Societies should not incur significant implementation costs and there is a potential for cost savings for some as a result of avoiding disputes that might otherwise have occurred.

Financial and other reporting (recommendations 43-45)

Financial reporting

78 The IS Act 1908 requires each society to deliver annual financial statements to the Registrar, and to a general meeting of the society for approval. The requirements do not stipulate any basis for preparation. The Commission notes that despite the relative simplicity of the reporting requirements, many societies struggle to comply.

79 The Commission assessed the issues against the three indicators of financial reporting identified by the External Reporting Board (XRB). The relevant indicator in this case is the "separation" indicator, which applies when there is a degree of separation between the owners from management and the owners are therefore reliant on general purpose financial reports to assess the financial performance, financial position and cash lows of the entity.

80 The Commission notes that this indicator is present in virtually all societies because of their structure. Societies' activities and business affairs are normally run by the society committee or executive separate from all of the other members. This separation suggests that some provision needs to be made to ensure members receive adequate information about their society. Therefore, it has recommended that incorporated societies continue to be required to prepare financial reports and submit them to a general meeting for approval.

81 The Commission has also recommended that preparation be governed by accounting standards issued by the XRB. This will mean that the great majority of societies would be eligible to prepare in accordance with one of the XRB's public benefit entity (PBE) simple format reporting (SFR) NFP standards. Those with annual operating expenditure of no more than $2 million would be eligible to prepare in accordance with the accrual-based SFR. Those with annual operating payments of no more than $125,000 would be eligible to prepare in accordance with the cash-based SFR.

82 The Commission also concluded that the current requirement to lodge financial statements with the Registrar should be retained because stakeholders advised the Commission that:

a. it is beneficial for society members to have access to financial statements easily and quickly
b. there are fewer problems with lost or missing records
c. it removes or resolves any argument over which is the authoritative set of financial statements.

83 We consider that the Commission's impact analysis of financial reporting issues could have been more thorough. We think it would have been useful to point out the following matters:

a. The small number of incorporated societies with annual expenditure of $30 million or more will need to prepare financial statements in accordance with PBE Accounting Standards (PAS), which are the most sophisticated NFP accounting standards. Those with $2 million or more but less than $30 million will be required to produce prepare in accordance with PAS, or the less complex PAS Reduced Disclosure Regime. In practice, there is likely to be little impact on the largest societies because there is evidence that most are already complying with generally accepted accounting practice.
b. The proposals will have no impact on the 7,500 or so incorporated societies that are also registered charities because they will, under recent changes made to the Charities Act 2005, be required to comply with the PBE NFP accounting standards for financial years commencing on or after 1 April 2015.

c. If the size profile of incorporated societies is similar to that for registered charities, then about 95% of the 16,000 or so incorporated societies that are not registered charities would be eligible for SFR reporting, including 75% for cash reporting.

d. The sector will need assistance in gearing up for these changes because most society treasurers are not accountants. Therefore, the legislative reforms should be complemented with sector education measures similar to those targeted at registered charities by the XRB, Association of NGOs of Aotearoa (ANGOA) and Department of Internal Affairs.

84 As has been acknowledged by the Commission in our discussions with them, financial reporting will be one of the two material compliance areas associated with the reform package. This is because treasurers will need to invest time to become familiar with the simple format NFP accounting standards that will replace the current financial reporting system, which has no recognition or measurement rules. They will also need to incorporate those requirements into their accounting records-keeping systems.

85 Although the Commission's analysis was incomplete, this is not enough to cause us to reject the recommendations. The preparation of reliable and understandable financial reports is an indispensable element of committee accountability to other members for the efficient and effective use of the resources under their control. The current reporting system is unsatisfactory because it permits societies to not apply basic recognition and measurement principles and does not require the disclosure of any information about the basis for preparation.

86 Research papers by Carolyn Cordery of Victoria University (in relation to small and medium-sized entities) and Rowena Sinclair of Auckland University of Technology (in relation to larger entities) demonstrate that the overall standard of financial reporting by registered charities is poor. We think it is likely that the same situation applies to incorporated societies because:

a. about one-third of incorporated societies are registered charities; and

b. there are no reasons for concluding that the overall quality of reporting by other two-thirds would be materially different.

87 We conclude that the additional compliance is proportionate to the benefits of substantially improved accountability to members.

Annual return requirement

88 Although societies are required to submit their annual financial statements, there is no annual return requirement of the type required under other incorporation legislation. This means that the Registrar does not obtain the type of information most needed to determine whether a society is complying with its core statutory obligations (e.g. whether it held an annual meeting), or with contact information.

89 The Commission considered whether the financial statement return is sufficient or whether a simple annual return form be introduced. It recommended that a simple annual return be required at the same time the financial statements are filed. The Commission stated that this change would improve the quality and accuracy of records held, and potentially provide some additional information that may allow Registry officials to improve services or policy affecting organisations on the register.

90 We consider that the Commission's analysis is correct in all respects. The annual return requirements should make a material contribution to promoting legal compliance. The compliance costs will be low because it will only take a few minutes for the form to be completed and sent to the Registrar. The exact detail of the annual return form can be finally determined following the ED process should there be issues with any of the form details proposed by the Commission.

Amending the constitution (recommendation 48)

91 The IS Act 1908 does not include any procedures to govern amending societies' constitutions. The Commission considered whether the new Act should.

92 The Commission noted that the power to alter a constitution can be a useful tool to modernise a society or to overcome problems. However, the power can also be used or abused to produce an unjust result for members. Therefore, the Commission recognised that the main trade-off is between:

a. the principle that societies should be self-governing; and

b. principles of transparency and governance, notably the risks of oppressive conduct by a small minority.

93 The Commission concluded that there should be no change on the main issue for two reasons. First, societies ought to be able to determine the method by which they will alter their constitutions. Second, one procedure could never reflect the diversity required within the sector.

94 The Commission also considered two options for minimum requirements for amending the constitution to manage the risks of oppressive conduct:

- Option 1 – Aligning the law with the Companies Act, which requires a special resolution of a minimum of 75% of voting shares cast on the question, or a higher percentage if required by the company's constitution.
- Option 2 – A minimum of the majority of members attending and voting on the matter at a meeting, or a higher percentage if required by the entity's constitution.

95 The Commission recommended option 2. It concluded that the situations for incorporated societies are different to those for companies. The great majority of incorporated societies operate on the one-member-one-vote principle. Therefore, it is unlikely that a small number of members will have disproportionate control, which is the risk that the minimum 75% requirement that the Companies Act provisions seek to reduce.

96 We consider that the Commission has correctly identified the issues, and that the analysis and conclusions are sound. We note, however, that the report contains no discussion of stakeholders' views on this issue. Nevertheless, we consider that this is insufficient reason to reject the Commission's recommendation. The one-person-one-vote principle is prevalent in the NFP sector and a 50% rule is fully consistent with that norm. . If there are issues, we would expect that they would become evident during the ED process.

97 This proposal will not have a large impact in itself, but is one of the many measures proposed by the Commission that will contribute to incorporating best practice into the way that societies operate. The compliance costs will be minimal, particularly for societies that adopt the model constitution (see the next section.

A model constitution (recommendations 51-56)

98 There is no legislatively prescribed model constitution for incorporated societies at present. The Commission states in its report that they heard many times during their consultation of societies with rules that did not serve the purpose of the society well because they were poorly drafted. Often those societies could not afford to buy in expert help at the time of incorporation and did not have access to experts within their membership. When problems later arose, resolving them became very frustrating, time consuming and often expensive.

99 The Registrar rejects about 150 applications a year due to non-compliant Rules. This is despite the legal requirements being clear in the current Act and on the registry website, and an example set of rules being available on the website. Applicants do usually manage to get their rules or constitution registered, but sometimes on the second or third attempt.

100 The Commission also noted that some applicants simply 'borrow' an existing constitution and replace original names with those for the proposed new society. The Commission stated that the not uncommon use of cut-and-paste versions of other societies' rules is unlikely to be a satisfactory basis for the formation and governance of the new society in the great majority of cases.

101 The Commission concluded that there should be a model constitution because it would reduce the incidence of problems with constitutions, enable societies to incorporate easily and cheaply, and provide societies with an assurance that those rules satisfied the statutory requirements.

102 The Commission also considered whether a model constitution should exist in or outside legislation (e.g. as a sample on the website of the Registrar, similar to the sample constitution that exists there now). The Commission concluded that there should be a model constitution in regulations made under the new Act. It expressed concerns with the website option that a society could not merely state in its application for incorporation that it wishes to adopt the model constitution if it only existed as a sample. The society would have to 'cut and paste' the model into its own document and submit it with other documents when applying for registration.

103 We consider that the Commission's analysis concluding that there should be a model constitution is sound. It is clear that the overall quality of society constitutions would be much lower if there was no model constitution.

104 However, we also consider that the means of making the model constitution requires further consideration. The Commission did not expressly identify a third option to list all the rules that must be included in constitutions in a Schedule to the new Act and include a statutory requirement for the Registrar to publish a model constitution that is fully consistent with the contents of the Schedule.

105 That said, we do not disagree with the Commission's main recommendation on this issue, which states that "the [new Act] should <u>enable</u> a model constitution to be made in regulations" [our emphasis]. Many Acts include regulation-making powers even when it is anticipated that those powers will not be used immediately upon enactment or for the foreseeable future. The powers are created because circumstances can change and it may be beneficial to use them at a later date. We have not attempted to determine whether it is likely that such a regulation-making would ever need to be used because it is impossible to know.

106 We propose to deal with this matter by including a model constitution in the ED package, but not as a set of draft regulations. Officials will provide advice to the government on the two options when reporting back on the outcome of the ED process.

107 This is one of Commission's major set of recommendations for the following reasons:

a. There is considerable scope for improving the overall quality of constitutions because a large number of incorporated societies have constitutions that are inadequate or not fit for purpose.

b. The model constitution will substantially reduce constitution-related compliance costs because:

i. 38 recommendations covering 13 topics and 50 subtopics impact on the mandatory requirements for constitutions; and

ii. it is likely that many incorporated societies will choose to adopt the model constitution in full or almost in full.

Minimum content requirements for constitutions (recommendations 57-65)

108 The Commission states that the IS Act 1908 provides only a skeletal framework for a society's constitution. The Commission's 2011 issues paper discussed whether a new Act should expand on the current list of subjects that societies are required to cover in their constitutions. The Commission outlined, by way of example, the provisions in the New South Wales Associations Incorporation Act 2009.

109 There was much support in the submissions for greater guidance in a new statute for societies writing their constitutions. Nearly two-thirds of submissions agreed that the New South Wales Act was a good starting point, although many thought that it was more prescriptive than necessary.

110 The Commission concluded that the new Act should include an expanded list of rules that all modern, well-managed incorporated societies should have, no matter their purpose or size. The Commission stated that it should cover both basic organisational rules, and basic accountability rules that protect membership involvement and democratic decision-making.

111 The remainder of this section of the Commission's report, which is nearly 10 pages long, comprehensively considers each issue relating to the minimum requirements. Appendix A of the Commission's report lists each of the rules it recommends should be mandatory for every constitution.

112 We consider that the Commission's analysis of the core issue (i.e. status quo versus expanded list) is sound. There is no plausible case for retaining the status quo. As to the detail, we consider that the Commission has been meticulous in identifying the issues and consistent in analysing them in accordance with the principles identified in paragraph 101 above. It is also evident that the Commission has thoroughly considered the intricate links between this issue and the many other recommendations in the report that impact on the content of the minimum rules.

113 The only other issue to consider is whether all of the detail is fully appropriate. We have not attempted to check this. We anticipate that any problems with the detail will be identified during the ED process.

114 The impacts of this set of recommendations have been incorporated into paragraph 107 above.

Internal dispute resolution (recommendations 66-75)

115 Incorporated societies have obligations to resolve or participate in the resolution of disputes or grievances that arise within their society. These obligations exist under case law. It is not well known that these obligations exist or what those obligations entail. Silence about internal dispute resolution in the IS Act 1908 means that it can be necessary to go to court, usually the High Court, to try and resolve the matter. This can be expensive and time consuming. The adversarial nature of the court system also means that the process can be divisive or even destructive within a society.

116 Perhaps two or three incorporated society disputes reach the High Court each year. This is not a high volume, but the Commission noted that it is almost impossible to tell how often the cost and difficulty of bringing a High Court action prevents society members from satisfactorily raising or resolving serious issues. The cases that do reach court suggest that a case usually needs a potential plaintiff with the resources to bring a case and enough at stake in terms of reputation, effect on career or control of disputed resources, to persist.

117 The Commission has recommended that societies be required to include procedures for dealing with internal disputes in their constitutions. It has also concluded that the new Act should leave societies free to continue, develop or adopt disputes procedures that meet their needs, so long as the society's procedures and practice satisfy natural justice requirements.

118 The Commission states that this change will not mean that all matters will be resolved through those dispute resolution procedures. Even if a society has well-developed procedures, members or office-holders may still elect to pursue external options, including court proceedings. However, the better designed the internal procedures are, the more chance of effective internal resolution. Even if this is not the case, there is a least a better chance that matters in dispute will have been defined and reduced to the essential minimum of core issues.

119 We consider that the Commission's analysis is correct in all respects. As with many other matters covered in the report, it is relatively easy to choose between a status quo comprising law that is incomplete, inaccessible and unclear, and legislative reform that comprehensively deals with those problems. Whether the Commission has got all of the detail right when balancing self-management and governance principles can be tested during the ED process.

120 This is one of the more significant set of recommendations in the report, not because the sector is disproportionately characterised by dispute, but because disputes can have very adverse impacts on individual societies. In the worst cases, disputes have been divisive or destructive and/or taken years to resolve. In other cases they have not been resolved in accordance with the principles of natural justice.

Civil enforcement (recommendations 76-85)

121 Under the current law, if a society or member alleges non-compliance with the constitution an action may be brought in the High Court for a remedy under the civil law. There are three main civil law routes: contract law, judicial review and declaratory judgments.

122 The Commission notes that none of these options is conceptually or practically satisfactory for incorporated societies. They are either limited in their application, or the courts have had to stretch the limits to suit the incorporated society context. As a result, time is spent not only arguing whether a remedy should be granted but also which cause of action is the appropriate mechanism for granting the remedies.

123 The Commission considered options for including new, simple and targeted civil remedies in the new Act. After applying legal principles to incorporated society circumstances, the Commission recommended that:

a. A society, a member or a former member (within the last six months) should be able to apply for court orders to enforce the constitution of an incorporated society

b. A society, and in certain limited circumstances, a member should be able to apply to a court for orders for redress from breaches of officers' duties

c. A member or former member (within the last 6 months) should be able to apply to a court for orders on the grounds that the conduct of the society has been, is being, or is likely to be oppressive, unfairly discriminatory, or unfairly prejudicial.

124 The Commission also recommends that the Registrar should have public enforcement powers in relation to enforcing constitutions and breaches of officers' duties. In keeping with the principle that members have the primary responsibility for holding societies to account, the Commission has stated that these should only be available to be used in the rare circumstances that it is in the public interest to do so.

125 The Commission also states that it is very unlikely that changes to court rules will be required to cope with the proposed new actions. The standard methods of commencing a proceeding can apply, and the current systems of case management should be flexible enough to deal with issues such as the possible need for discovery, or opportunities to deal with a straightforward matter through a summary process, settlement conference or short trial.

126 We consider that the Commission's analysis is sound. The current law on dispute resolution, where matters do go to court, is very unsatisfactory. There is a clear need for a coherent set of rules that are designed for purpose. There is also a need for the Registrar to have powers to take court action in the rare circumstances where there have been serious breaches of officers' duties and the prohibition on monetary gain.

127 We also consider that there is a need for further consultation. Although the Commission discussed the equivalent provisions in the Victorian Association Incorporations Act 2012 in its 2011 issues paper, the Commission's detailed proposals have not been fully tested with stakeholders. This issue can be managed through the ED process.

128 These changes will not have any impact on most societies because there are few cases. However, there will continue to be a very small number of cases and it is clear that the current inadequate framework for considering them needs to be improved.

Criminal sanctions and the powers of the Registrar (recommendations 86-88)

129 The IS Act 1908 provides a small number of minor administrative offences and more significant offences, with a range of maximum fines, all of which are very outdated , such as:

a. 10 cents a day per officer for operating an incorporated society without having a registered office)

b. $200 for a society and $40 for a member for contravening the monetary gain prohibition.

130 The Commission considered options for thoroughly modernising the regime in accordance with modern enforcement principles. This included consideration of options for a wider range of remedies and penalties used in more recent legislation, including banning orders and infringement offences. The Commission identified and analysed the issues in accordance with the theory of criminal sanctions (i.e. to maintain law and order, protect society by punishing the wrongdoer, denounce the conduct and promote general deterrence).

131 On that basis, and consistent with the principles of incorporated societies described in paragraph 14 above, the Commission agreed with the majority of submitters that:

a. generally criminal sanctions are not required for incorporated societies

b. enforcement should usually be by members via the society's constitution and civil law

c. criminal offences should be reserved for situations involving dishonesty

132 The current very low maximum penalties mean, on occasions, that the Registrar does not take cases where it might be in the public interest to do so. This is unsatisfactory both in terms of condemning the specific conduct and for general deterrence.

133 The Commission has recommended 10 criminal offence provisions with different maximum penalties depending on the seriousness of the conduct, and a new infringement offence regime covering seven less serious contraventions. The Commission has also recommended that a court should have the power to ban a person from holding a position of management or from being the statutory officer upon conviction of a criminal offence under the Act.

134 We consider that it is clear from the report that the Commission's use of the theory of criminal sanctions provides an appropriate framework for considering the issues and that the Commission has carried out a thorough analysis. The proposed individual offence provisions are the result of systematic consideration of the full range of obligations under the new Act with appropriate reference being made to similar types of offence provisions under other Acts.

135 There may be some overlaps with offence provisions in other Acts (e.g. the Crimes Act 1961). We expect that these issues will be identified and resolved during the process of preparing the ED and the Bill of Rights Act vetting process that is routinely carried out by the Ministry of Justice before proposals can be submitted to Cabinet for the introduction of Bills into the House.

136 We also accept the Commission's analysis on banning order provisions, which are routinely included in modern governance statutes. Consideration will also be given during the drafting and ED stages to the benefits and costs of broadening the disqualification powers to recognise banning decisions made under other New Zealand Acts (e.g. the Companies Act) and/or under similar incorporated society legislation in other countries.

Terminations, restructures and rescues (recommendations 96-98)

137 The Commission has considered whether the amalgamation and merger, and voluntary administration (VA) options provided in the Companies Act should be made available to incorporated societies. The Commission notes that it is important for societies to be able to come together and form new or revised societies when they choose. It recommends an amalgamation regime modelled on the Companies Act provisions.

138 The major benefit of the VA system in the Companies Act is to provide a short moratorium while an insolvency practitioner or turnaround specialist continues to run the entity and considers and reports to creditors on the potential for rehabilitating the company or some of the business of the company. The Commission notes that VA allows at least the possibility of a rescue and restructuring rather than just a decent burial. It recommends that financially distressed should have the option of being placed into VA.

139 We note that the Commission has not included any commentary on how frequently they would expect the new processes to be used if applied to incorporated societies. In addition, there is no indication of any submitter feedback on these matters. However, we do not think that this detracts from the Commission's conclusions. The legal frameworks for these processes already exist under the Companies Act and it should be relatively easy to apply them to incorporated societies under the new Act. The costs of change are low and even relatively little use of them should be of net benefit.

140 Based on our knowledge of the Companies Act provisions, our preliminary conclusions are that:

a. there may be moderate use of amalgamation and merger, which could have a moderate impact on sector rationalisation

b. there will probably be little use of VA. VA will only be only viable for the very small proportion of incorporated societies with substantial operations, assets or potential cash flow because the cost of engaging a professional practitioner to be the administrator can be significant.

141 We expect that it would be made known to us during the ED process if either of these preliminary views was incorrect.

The Charitable Trusts Act 1957 (recommendation 2)

142 The Charitable Trusts Act 1957 (CT Act) includes two choices for incorporation: incorporation as an incorporated charitable trust board (an unusual hybrid of a trust whose purposes are charitable, plus the incorporation of its trustees as a board) or a charitable society. The CT Act has its own definition of charitable purposes, separate from the Charities Act 2005. Charitable societies and incorporated charitable trust boards may choose to seek separate registration as a charity under the Charities Act, or seek tax exemption under Inland Revenue's rules, or both, or neither. Incorporated societies may do the same if they have charitable purposes, and up to a quarter do so.

143 Information obtained from the Commission and Registries staff suggests that only a few hundred of the 22,000 entities registered under the CT Act are charitable societies, though this figure is difficult to verify because the register does not distinguish between charitable societies and incorporated charitable trust boards.

144 The Commission stated in its report that they were told during consultation that the choice between forming an incorporated society and establishing a trust with an incorporated trust board was sometimes made not so much with the underlying differences of those models in mind but rather as a view to administrative convenience (e.g. because there are no financial reporting obligations under the CT Act).

145 The Commission considered the options of removing the ability for charitable societies to incorporate under the CT Act and requiring those that are currently incorporated under that statute to transition to become societies incorporated under the new Act. In assessing these options, the Commission noted that societies are member-driven institutions. Incorporated societies law is designed to protect membership involvement and a degree of democratic decision-making. Trusts are not about either of those things because they are generally not structured along democratic lines. They are a way of holding and distributing property.

146 The Commission has concluded that societies should no longer be permitted to register under the CT Act. It also recommended that existing societies registered under the CT Act should be required to re-register under the new Incorporated Societies Act.

147 We consider that the Commission's analysis is correct in all respects. The status quo is wholly inconsistent with the principle that societies are organisations run by their members. There are no reasons to override that principle.

D3. Agricultural and Pastoral Societies (recommendation 3)

148 Country shows in New Zealand are, almost without exception, organised by agricultural and pastoral (A&P) societies. There are more than 100 A&P societies in New Zealand and it appears that most of them belong to the Royal Agricultural Society (RAS).

149 There are numerous A&P society-related statutes. The main statute is the Agricultural and Pastoral Societies Act 1908 (A&P Act), which provides for the registration of A&P associations. There are also three A&P Societies Amendment Acts (1912, 1920 and 1933) which amend the A&P Act but contain stand-alone provisions that need to be read together with the A&P Act. It is not known how many entities are incorporated under the A&P Act because it does not include a power for the Ministry for Primary Industries or any other government agency to operate a public register. Perhaps there are about 90.

150 Another 21 A&P societies are registered under the IS Act 1908. 16 of those 21 have registered under the IS Act 1908 in the last 20 years. It is evident from studying their rules that most if not all 16 had been incorporated under the A&P Act.

151 Two joint venture boards involving A&P societies are constituted under Private Acts: the Auckland Agricultural Pastoral and Industrial Shows Board Act 1972 (Auckland AP&I Act) and the Waikato Show Trust Act 1965. There are also seven Private Acts, one Local Act and one Provincial Ordinance that have other purposes, mainly to allow individual A&P societies to sell or use land in ways that are prohibited by the A&P Act.

152 More detailed description of the Acts in this sector appears below.

The Agricultural and Pastoral Societies Act 1908

153 The A&P Act has similarities to the IS Act 1908 in that it is silent on internal dispute resolution and on several essential matters relating to governance, rights and obligations. There are also some significant differences.

a) Section 3 requires the minimum membership number to be 50, not 15.

b) Sections 7 to 9 (including additions made to section 7 by the 1912 and 1920 Amendment Acts) impose tight restrictions on selling, buying and mortgaging land.

c) Section 12 includes a long list of general bylaws that apply to all A&P societies. Several of those general bylaws are inconsistent with the principle that societies are private bodies which should be self-governing and free from inappropriate state interference. Provisions in the general bylaws that are or may be inconsistent with that principle include:

   i. Specifying a quorum of 20 at all general meetings – This requirement applies no matter how many or few members the society has

   ii. Specifying a quorum of one-third for all meetings of the committee

   iii. Stating that the chairman shall have a deliberative vote and, in the event of a tie, a casting vote

   iv. Stating that all officers shall continue in office until their successors are appointed

   v. Prohibiting ordinary members from voting at a general meeting if they have not paid their annual fees for the previous year

   vi. Specifying a minimum vote of three quarters of the members present for the purpose of expelling a member

   vii. Prohibiting society treasurers from retaining more than $40 in sums received.

d) One of the general bylaws in section 12 requires A&P societies to select their auditors from among their ordinary members. This provision is contrary to the most important principle of auditing: the auditor must be, and be seen to be, independent. No professional accountant could accept such an engagement because it would be wholly inconsistent with the professional and ethical standards (PESs) issued by the XRB, particularly PES 2. To put it another way, the A&P Act prohibits the best qualified people from doing the work.

e) Some provisions are outdated for other reasons. For example, section 6 of the 1933 Amendment Act provides members, officers, agents and servants of societies with police-like powers to remove persons from A&P society premises for breaching bylaws made by the society under the 1933 Act. It is clear that this power is no longer appropriate.

The Auckland Agricultural Pastoral and Industrial Shows Board Act 1972

154 The Auckland AP&I Act constitutes the Auckland Agricultural Pastoral and Industrial Shows Board. The Board is a joint venture of the Auckland Agricultural and Pastoral Association (which is incorporated under the A&P Act) and the Auckland Manufacturers' Association (which is registered under the IS Act 1908). The Board is responsible for organising and running the annual Easter Show that has, in recent years, been held at the ASB Show Grounds in Epsom, Auckland. The main purpose of the Auckland AP&I Act is to protect the Board's assets from ending up in the hands of a body that is not charitable should the Board be dissolved.

155 Schedule 2 includes a highly prescriptive Board constitution. The provisions of Schedule 2 may be altered or added to by agreement between the Board and its two constituent associations, with the approval of the Minister of Agriculture and Fisheries.

The other Acts

156 Several other Private Acts,[3] along with one Local Act[4] and one Provincial Ordinance[5] impact on individual A&P societies. It appears that the common purpose of all but one of these Acts is to empower the relevant associations to act in ways that are either prohibited by or inconsistent with the A&P Act. For example:

a. The Waikato Show Trust Act 1965 was enacted to permit the establishment of a joint venture Board of Control between two A&P societies that had complementary assets. One society owned land and the other wanted to erect buildings on the land. The Preamble to this Act notes that "there is no power in the [A&P Act] to give effect to the intentions and desires of the two… associations."

b. The Kumeu District Agricultural and Horticultural Society Act 1991 allows the Society to use its property for a range of purposes that are not permitted by the A&P Act. These include cultural purposes or entertainment, trade promotion, tourism and greyhound racing.

c. The Southland Agricultural and Pastoral Association Empowering Act 2006 overrode the A&P Act by permitting the Association to sell 16 hectares of land in Invercargill.

The Commission's consideration of the issues

157 The Commission's 2011 issues paper asked submitters whether there was merit in moving to a generic not-for-profit statute which might include bodies currently incorporated under the A&P Act. A relatively large number of submissions were received from current A&P societies which generally opposed such a move. The Commission concluded that the new Act should provide for an easy and efficient mechanism for A&P societies to transfer incorporation voluntarily from the A&P Act to the new Incorporated Societies Act.

MBIE's assessment

158 We consider that more work is needed before deciding whether to accept this recommendation because our preliminary view is that A&P society legislation has all the main problems of IS Act 1908 plus some additional problems. If our preliminary assessment is correct then the Commission's recommendation will not adequately deal with the problem. A&P societies which chose to remain under the A&P Act would continue to operate under a legislative framework that is outdated, incomplete and inflexible, and in ways that are inconsistent with modern governance norms in several important respects.

159 We consider that there are three options:

- Option 1: Decide now that A&P societies will be required to re-register under the new Incorporated Societies Act
- Option 2: Enact a new A&P Societies Act adopting many of the same changes that are proposed to be made in the new Incorporated Societies Act, along with other changes that are needed to deal with the additional problems

[3] Canterbury Agricultural and Pastoral Association Empowering Act 1982, Clevedon Agricultural and Pastoral Association Empowering Act 1994, Kumeu District Agricultural and Horticultural Society Act 1991, Marlborough Agricultural and Pastoral Association Empowering Act 1974, Southland Agricultural and Pastoral Association Empowering Act 2006, Tokoroa Agricultural and Pastoral Association Empowering Act 1968 and the Waikato Show Trust Act 1965.
[4] Taranaki Agricultural Society Empowering Act 1909.
[5] Northern Agricultural and Pastoral Reserve Management Ordinance 1871 (O).

- Option 3: Defer a decision on whether to adopt the Commission's preferred option, option 1 or option 2 until after the legislation ED process has been completed.

160 We prefer option 3 for two reasons:

a. We do not have sufficient information to provide definitive advice to the Government at present. We first need to consult with the sector and obtain a fuller understanding of their circumstances, including testing whether the concerns are primarily based on a perceived loss of status. This could include targeted consultation with A&P stakeholders before the ED is released.

b. To date A&P societies have only had the opportunity to think hypothetically about the consequences of A&P society incorporation under a new IS Act. Option 3 will provide A&P stakeholders with the opportunity to make objective judgments because they would have clear information about the proposed new IS Act and model constitution and they would be able to assess the impact on A&P societies in a real sense. Providing the sector with a real draft Bill and model constitution will move the debate from the conceptual to the practical.

Consultation

161 Apart from this paragraph, this consultation section of the RIS was largely written by the Commission. In summary, we consider that what is outlined below conclusively demonstrates that, apart from the issues relating to A&P societies, the Commission's consultation processes were very thorough, exceeded the minimum standards that are generally expected in relation to public policy reform processes and have contributed to consensus building about the need for legislative reform.

Who was consulted

162 The Commission consulted relevant stakeholders by several complementary means. It released an issues paper calling for submissions in June 2011. As well as discussing possible issues, the issues paper posed 44 specific questions to seek submitter input on key problems. Over 200 submissions were made and formed a major contribution to the outcome of the Commission's report.

163 To encourage submissions and engage directly with stakeholders, the Commission worked with community groups to arrange public meetings in Dunedin, Thames, Hamilton, Waitakere and North Shore. All meetings were well attended. Specific tāngata whenua input came from consultation with the Māori Liaison Committee the Law Commission has brought together; and a March 2013 hui which included a variety of Waikato groups and people.

164 The Commission consulted directly with interest groups and societies throughout the review, including Federated Farmers, Clubs Inc (an umbrella group for chartered and recreational clubs), Council of Trade Unions and NZ Racing Board. Consultation with government agencies included Sport New Zealand, MBIE (including the Registrar of Incorporated Societies and other Registries officials) and Ministry of Justice.

165 The Law Commission formed a reference group to provide on-going feedback and testing of proposals, as the project developed. The reference group included representatives of community groups, legal experts who work with societies and charities and Registries officials. Three full meetings of the group were held over 2012 and 2013 and its input informed the final report.

What was said

166 The majority of submitters accepted the need for comprehensive reform, including a new Act. They accepted that the IS Act 1908 is deficient in several areas including governance, conflicts of interest, dealing with disputes and the requirements for constitutions of societies. They generally supported the publishing of a model constitution, and saw this as likely to be of much help to societies reviewing their own constitutions. Societies also emphasised that, apart from basic minimum requirements of modern governance, societies should remain free to develop their own arrangements, according to their society's needs and objectives.

167 The hui at Waikato was very supportive of the broad shape of the recommendations developed by the Commission, including the emphasis on ensuring structures for good governance. There were particular comments on the need to build in dispute resolution systems from the start of a society. Several attendees reflected on how this could have helped deal with disputes that had arisen in the Waikato.

168 The reference group supported the overall recommendations, and offered particular feedback on how to develop and use a model constitution to best effect so that societies are not discouraged from developing provisions that are appropriately tailored to them.

169 A minority of submitters favoured retaining the status quo. They consider that the IS Act 1908 is generally sufficient to allow like-minded persons to incorporate as societies and does not impose additional government requirements or restrictions on the operations of societies. This section of submitters also tended to think that:

a. the current minimum requirement for 15 members on incorporation is adequate or appropriate, and should stay

b. committees or societies should be left to make their own decisions on governance arrangements and structures

c. the IS Act 1908 or a new Act, should not include conflict of interest rules.

170 The Implementation section below outlines further consultation processes that will be undertaken before a Bill is introduced into the House.

Conclusions and Recommendations

171 The Commission's report addresses a small number of significant issues and a large number of smaller issues that together add up to a lot. In particular, it is clear that the performance of the sector can be substantially improved by enacting a new IS Act that:

a. Sets out a basic set of duties for committee members modelled on company directors' duties, particularly a requirement to act in good faith, a requirement to act in the best interests of the society and to only use powers for a proper purpose.

b. Provides a description of financial conflicts of interest and a procedure for dealing with them.

c. Provides for certain information to be provided to members, particularly understandable financial reports.

d. Requires every society to include disputes procedures in their constitution.

e. Provides for a model constitution.

172 There will, as a consequence, be new compliance costs for societies, mainly in the form of additional time commitments for committee members. Most of these commitments will be relatively small, but there will be two material costs. As acknowledged by the Commission, those costs relate to:

a. The need for treasurers to become familiar with one of the two simple format NFP accounting standards issued by the XRB.

b. The need for every society to review its constitution.

173 The costs associated with reviewing the constitution are not linked to a single recommendation or even a single group of recommendations. Appendix A of the Commission's report helpfully details the 38 recommendations which have implications for the minimum constitutional requirements.

174 We accept the Commission's conclusion that most societies will choose to adopt the model constitution, so the time commitment for them will be significantly lower. The only cost for societies adopting the model constitution will be to add descriptions of the society's purpose and goals. MBIE's experience arising out of consultation on financial reporting reforms that will come into force for registered charities in 2015 is that most NFP entities already focus on these matters. Furthermore, the review process will benefit older societies which have purpose and goal statements in their constitutions that are out of date.

175 In addition, the extensive education programme outlined in the implementation section below will contribute to reducing the compliance cost increases by assisting the sector with the transition.

176 Our overall conclusion is that significant performance and accountability improvement benefits will be obtained by replacing the clearly inadequate IS Act 1908 with modern legislation that will help societies to attain their goals. We also consider that those benefits will outweigh the compliance costs. We recommend that the Government accepts the great majority of the Commission's recommendations in full or in principle and that a draft Bill and regulations based largely on the Commission's recommendations be exposed for public comment before the Bill is introduced into Parliament.

Implementation

177 The reforms can only be successfully implemented if the not-for-profit sector broadly understands them and has sufficient time to implement the changes. This has the potential to be challenging given that the great majority of incorporated societies are small, run by volunteers and do not have the resources to obtain professional advice. Our view is that the only plausible option is for the relevant government agencies to work closely with major not-for-profit umbrella organisations with the aim of making it relatively easy for society officers to implement the changes for their societies. We consider that all of the following options would contribute to a successful transition:

a. To have a reasonable transition period, as proposed by the Commission in recommendations 55 and 56. Our view is that societies should be given two years after the legislation is enacted to make changes to their constitutions in accordance with the new Act. The main cost of a long transition is to delay obtaining the benefits of the improved modern law by about a year. However, shortening the transition may also mean that some changes to constitutions will be rushed and low quality. Alternatively, if the changes are not completed on time the society would be automatically dissolved. The society would then need to apply to be reregistered under the new Act.

b. To produce a model constitution that could be adopted or easily adapted by societies. A model constitution will substantially reduce the costs for the sector and improve the quality of constitutions.

c. To issue EDs of the Bill and model constitution before the Bill is introduced into Parliament – This approach is likely to delay the law being brought into force by about a year, but in our experience the quality of the law is usually much higher when time is taken over legislation that extensively overhauls or replaces existing legislation.

d. To have road show presentations on the EDs – Road shows will increase awareness of the reforms and promote informed comment.

e. To produce and publicise plain language guidance material – This will contribute to societies having the information they need to make changes to their constitutions.

178 It will also be important to obtain a Māori perspective by consulting with Māori experts, communities and incorporated societies. This will include obtaining expert advice about recommendation 46, which proposes that a society should be able to express its tikanga or culture in its constitution.

179 The cost of the work carried out by government agencies will be met from existing baselines. We estimate that their opportunity cost of staff time and other costs such as travel and accommodation combined will be about $100,000.

180 Subject to other priorities that might arise, our indicative timeline is as follows:

- March 2015: Release of draft Bill and model constitution for public comment
- May-July 2015: Road show on the draft Bill and model constitution
- September 2015: Deadline for comments on the Bill and model constitution
- June 2016: Introduction of the Incorporated Societies Bill.

Monitoring, Evaluation and Review

181 We expect that any significant problems with the new legislation will become evident within five years of it coming into force. We will monitor progress during that period by contacting the key stakeholders including NFP sector umbrella organisations and experts, and the regulator. What happens after that will depend on the feedback we obtain. If it eventuates that the reforms have largely been successful, we would expect that any subsequent review would occur decades rather than years later. The NFP sector needs legislative stability because it has very limited capacity to employ legal staff or obtain professional legal advice.

Annex 1: Technical revisions and changes that have no or only minor regulatory impacts

Rec. No.	Issue	Reasons the RIS does not discuss the issue
46	The statute should permit rules to be made that empower it to make bylaws, express its tikanga or culture, and provide for any other matters relevant to the society's affairs.	Has no or only minor impacts on not-for-profit entities
47	Bylaws made or continued under the new statute should no longer be subject to the Bylaws Act 1910.	Has no or only minor impacts on not-for-profit entities
49	The registration of amendments should remain largely unchanged from s 21 of the IS Act 1908 1908.	Substantially re-enacts the current law
50	The court's power to amend a constitution should be carried over from s 21(3A) in the IS Act 1908.	Substantially re-enacts the current law
85	The new Act should provide that a society may apply to a court for orders to restore to the society any money wrongly paid to members as being a breach of the prohibition against monetary gain.	Substantially re-enacts the current law
89	The statute should provide the Registrar with the certain investigation, inspection and other powers within a statutory framework similar to that in Parts 1 and 2 of the Corporations (Investigation and Management) Act 1989.	Involves consolidations that substantially re-enact the current law
90-95	Retain dissolution and liquidation processes for incorporated societies.	Substantially re-enacts the current law

Glossary

Term	Meaning
A&P society	Agricultural and pastoral society
A&P Act	Agricultural and Pastoral Societies Act 1908
ADLS	Auckland District Law Society
ANGOA	Association of NGOs of Aotearoa Incorporated
Auckland AP&I Act	Auckland Agricultural Pastoral and Industrial Shows Board Act 1972
CT Act	Charitable Trusts Act 1957
ED	Exposure drafts of the Incorporated Societies Bill and regulations, recommended to be released for comment before the Bill is introduced into Parliament
IS Act 1908	Incorporated Societies Act 1908
MBIE	Ministry of Business, Innovation and Employment
New IS Act	The new Incorporated Societies Act which would replace the IS Act 1908
NFP	Not-for-profit
NGO	Non-governmental organisation
NZLS	New Zealand Law Society
PAS	PBE Accounting Standards
PBE	Public benefit entity
RAS	Royal Agricultural Society
Rec. No.	Recommendation number
Registrar	Registrar of Incorporated Societies
RIA	Regulatory impact analysis
RIA No.	RIA number
RIS	Regulatory Impact Statement
SFR	Simple format reporting
VA	Voluntary administration
XRB	External Reporting Board