INDEPENDENT STATE OF PAPUA NEW GUINEA.

Consultation Memorandum

Seeking Stakeholder Input to Proposed Amendments to the

ASSOCIATIONS INCORPORATION ACT of 1966

INTRODUCTION

This Consultation Memorandum contains a narrative description of issues to be addressed in a future amendment to the Associations Act of 1966.

PURPOSES OF THE PROPOSED AMENDMENT

This Consultation Memorandum is intended to elicit feedback on issues proposed to be addressed in a future amendment to the existing Papua New Guinea ***Associations Incorporation Act of 1966 (Associations Act)***. The Associations Act has remained unchanged since its passage. The proposed changes are intended to: i) address issues that have been identified as problematic for local associations; and ii) bring the Act into compliance with international anti-money laundering (AML) mandates aimed at bringing a higher level of transparency and accountability to this business entity type.

With regard to AML issues, this reform is being driven in part by deficiencies noted with the Associations Act noted in the 2011 "Mutual Evaluation Report" (MER) prepared by the Asia/Pacific Group on Anti-Money Laundering. In response to the MER, Papua New Guinea has been working on a "National Anti-Money Laundering and Counter Terrorist Financing Strategic Plan 2017-2027" (NSP)[1] which contains a section that addresses AML issues. The NSP states that Government will:

> Conduct review of *Associations Incorporation Act* … to ensure proper registration of Non-Profit Organisations (NPOs), enable information with respect to NPOs to be made available to investigative authorities with a view to ensure:
>
> 1. NPOs are not misused by terrorist organisations posing as legitimate entities;

[1] Last updated June, 2017, this has now been endorsed by the National Coordinating Committee. See also the related document "Money Laundering and Financing or Terrorism National Risk Assessment" dated September 2017.

2. NPOs are not used to exploit legitimate entities as conduits for TF, including for the purpose of escaping asset-freezing measures, and
3. NPOs are not used to conceal or obscure the clandestine diversion of funds intended for legitimate purposes to terrorist organisations.[2]

The NSP also picks up on specific recommendations from the international AML Guidelines and states that the following directives should be considered in new legislation:

> Additionally, those NPOs that are of appropriately large size, or which are operating internationally should be required to:
>
> 1. Maintain information on the purpose, objectives and control of their activities
> 2. Issue annual financial statement providing detailed breakdown of income and expenditure
> 3. Have controls in place to ensure funds are accounted for and spent correctly with the NPO's stated activities and purpose
> 4. Be licensed or registered
> 5. Follow a 'know your beneficiaries and associated NPOs' rule, and
> 6. Maintain for at least 5 years and otherwise in accordance with legislative requirements, records of domestic and international transactions, in addition to the info above.

Against this background, a number of themes have been identified as potentially being worthy of statutory amendments, including: improving the incorporation process by better defining what information is needed in the application; defining what types of groups are eligible to become associations; creating subtypes of associations so as to be able to tailor specific rules for each subtype; clarifying the proper grounds for an objection to the formation of the association; providing for a higher level of financial transparency for associations, including giving members certain rights to obtain more information about their association; clarifying the rights and responsibilities of the committee of the association; clarifying the responsibilities of the public officer; making clear what powers an association has; requiring an annual filing of some sort so as to provide the registry with accurate information as to what associations are active or inactive; re-examining the penalties in the current Act as they are so inconsequential that there is no incentive to comply with the law; and setting forth in greater detail the role of the Registrar in administering the Act.

This Consultation Memorandum is a joint effort between the Investment Promotion Authority and the Pacific Private Sector Development Initiative, an Asian Development Bank program undertaken in partnership with the governments of Australia and New Zealand. This Consultation Memorandum will be widely distributed to the public and Government departments and agencies. There will also be public events where stakeholders may ask questions and voice their comments on the issues raised in this Memorandum.

[2] See Recommendations 23 and 24, page 33-34 of the NSP.

The remainder of this Consultation Memorandum provides a narrative overview of the main areas under discussion for change. There is no question but that some issues identified represent basic a fundamental change in the way associations would be viewed under the law and that these issues will likely produce spirited discussion. The IPA welcomes such discussions and will view all stakeholder input with the sensitivity and respect it deserves. ***All comments should be submitted to IPA at the following email address:*** ggLegislativeReview@ipa.gov.pg

Narrative discussion of proposed amendments

The updates currently under consideration for a proposed amendment may be grouped in the following categories:

1) Process to become an association

The current Act requires that a notice of intent to incorporate first be presented to the Registrar, and if that is in order then newspaper publication of the intent is required. Members of the public have the right to object to the formation. If no objections are made, then the applicant has several more months to return to complete the application. If Objections are lodged, then first the Registrar and ultimately the courts must decide if the incorporation should be allowed. Certainly this process is cumbersome, but given the competing interests involved it seems logical to retain the requirement for a public notice to be given prior to the incorporation of the entity. However, the process can be improved by more clearly specifying the information that is required to be submitted to the Registrar as part of the initial notice of intent to incorporate. This can be done through changes to the regulations under which the notice of intent is prescribed.

The current regulatory changes under consideration would require that information to be submitted with the notice should mirror what will be required in the final application. Currently the public is not fully informed on the particulars of an association at the application stage so as to make a fully informed decision on whether to object to the association's incorporation. Therefore, matters related to such things as the objectives of the association, its membership qualifications, the address of the principal place of business of the association, and the names of the initial committee members should all be included in the initial notice. Many of these items will be addressed in the association's constitution, which should be attached to the notice of intent to incorporate.

This approach will leverage the online registry administered by IPA. The information in the application can be published to IPA's registry website, including images of paper documents filed with the Registrar. This means that the totality of the notice to incorporate is be viewable by the public. The publication of the notice of intent to incorporate in the newspaper can reference this website, thus eliminating the need for IPA to publish all information in the paper. Interested parties can view the entirety of the application for themselves to determine if they should raise an objection. This change will bring much improvement to the formation process.

2) Subtypes of associations and other organizational issues

The current Act takes a one-size-fits-all approach to associations: there are no subtypes. There may be benefits to having each Association self-designate as a "charitable," "religious" or some other type of association. This would facilitate crafting specific regulations for each subtype and with the collection of statistics. For example, rules around how assets of dissolving association are to be distributed should differ for a truly charitable enterprise that has raised funds via public donations vs. an entity like a Chamber of Commerce that is funded by payments from its members. If the law recognized the subtype "Charitable Association" vs. what might be called a "Member Benefit Association" then it would be possible to craft such distinctions in the law.

3) Types of groups that should be eligible to become associations

The original intent of the Associations Act was to allow a means by which charitable and religious groups could incorporate. In recent years two types of groups have registered as associations that may not fit within this original intent: incorporated land groups and political parties.

Incorporated Land Groups (ILGs) are distinct legal entities created under the Land Groups Incorporation Act 1974. Oddly, many ILGs are also registered as an association. Anecdotal reports indicate this has occurred because banks are unwilling to open accounts for these entities based solely upon the ILG Certificate of Incorporation. It is unknown why this practice started, thought it could simply be because IPA records are more easily accessible than those held by Lands as IPA records are online. Regardless, there is no reason for ILGs to be registered in two different places and this practice should cease.

Political parties are currently organized as Associations. However, they are also supposed to be registered under the "*Organic Law on the Integrity of Political Parties and Candidates."* PNG should cease the practice of requiring political parties to be Associations and instead have them register only under their own law.

4) Clarifying the proper grounds for an objection to the formation of the association

Section 4 of the current Act sets out the grounds upon which an objection to the formation of an association can be made. Anecdotal reports from the IPA indicate that they often receive objections that are rational and compelling, but don't fit squarely within the confines of the list found in Section 4. For example, under Section 4 technically no objection could be made even if the applicant had been convicted of a felony for fraud in collecting monies for charity.

The grounds for objection to the formation of an association should be made more broadly defined, giving greater latitude to the objector. Conversely, if there is a concern that this change might greatly increase the number of nuisance objections, the Registrar could be given the ability to reject an objection on the grounds that it is frivolous or vexatious, and if this decision were upheld up on appeal in court, the objector could be required to pay the Registrar's expenses in defending the suit.

5) Financial Transparency

The current Associations Act provides an adequate framework under which smaller, traditionally charitable or religious organizations may operate. However, the use of the association form has changed over the years so as to be used for organizations that handle very large sums of money with little or no accountability to their own members. The changes under consideration related to financial transparency are aimed at bringing more transparency to these large organizations, with the goal being to the benefit the people of PNG. It is critical to note that these changes *are required* by international AML guidelines and have been endorsed by the Government of PNG through the NSP process.

There a variety of ways in which to bring financial transparency to associations, and the IPA seeks input on the best approach. The desired goal is to bring transparency to the larger associations without imposing undue burdens upon smaller, purely charitable entities. In this light, while the most all-inclusive change would be to require all associations to file annual audited financial statements with the Registrar, IPA believes this approach would be too burdensome on smaller associations. Further, there are some associations that, as a matter of good public policy, might not be appropriate targets for financial disclosure requirements. For example, it might not be appropriate to impose stringent financial reporting requirements on churches organized as associations unless some high annual turnover threshold is reached.

The following considerations are being reviewed in relation to financial disclosures:

Consideration 1: smaller associations should not be burdened with these filings. Therefore, no reporting should be required of an association in a reporting year in which its gross turnover was below some kina amount.

Consideration 2: no association whose primary objective is religious should be subject to stringent reporting requirements. Instead, a better course might be to give church members themselves greater access to financial records of the entity.

Consideration 3: the actual documents relating to the financial standing of the entity should not be overly complicated. It may be appropriate to only require a simple balance sheet and income-expenditure statement dated as of a date no more than 30 days in advance of the date of filing. On the other hand, international AML standards require each association to keep detailed records with regard to donations received and how those donations are spent. These records should be available for inspection by appropriate government officials.

Consideration 4: requiring financial reports to be audited by an independent third party would bring the highest level of confidence in the reports, but before imposing such a requirement it must be certain that the increased burden will yield desired benefits. Further, it must be certain that the market has an adequate supply of auditors. It might be that only the largest associations should have an audit requirement, perhaps those with a very high gross annual turnover.

Consideration 5: provide members with certain rights to inspect some association records. The current Act does not contain language that specifically gives members rights to inspect association records. Members should have some visibility into basic association records, especially because many associations either accept money from their members or hold money received from third parties for the benefit of their members.

A model to use as a guide in this area could be the PNG company act, which basically gives directors access to nearly all company records, but provides that shareholders may only review certain records. By analogy, a member in an association could be treated like a shareholder in a company. In combination with financial reporting requirements noted above, these provisions would give association members a useful window into the operation of their associations.

6) Rights and responsibilities of committee members

Conceptually, the committee of an association is roughly equivalent to a board of directors of a company. The Act would benefit from a specific statement of the rights and duties of persons acting as a committee member, including addressing such things as: imposing a duty of loyalty upon Committee members, defining and addressing conflicts of interest, and giving rise to liability for the intentional misuse of funds. The PNG Companies Act imposes these sorts of duties on the directors of a company and can serve as a model for the Associations Act. The basic duty that would be set out in the amendments would be to be act in the interests of the Association:

> A Committee Member of an Association, when exercising powers or performing duties in this capacity, shall act in good faith and in what the member believes to be in the best interests of the Association.

When considering the duties that should be imposed upon Committee Members, it is also likely that some modifications to those derived from the Companies Act would be appropriate. Many committee members for charitable associations serve on a volunteer basis and thus should have not be subject to the same level of scrutiny as would directors in a for-profit enterprise. Language that protects committee members when they are acting in good faith should be considered for inclusion in any amendment, such as the following:

> Notwithstanding any other provision of this Act, a committee member of a charitable association shall not be liable to the Association or its members for money damages for any action taken, or any failure to take any action, as a committee member, except liability for:
>
> (1) the amount of a financial benefit received by the committee member to which the committee member is not entitled;
> (2) an intentional infliction of harm;
> (3) a violation of this Act in relation to the failure to disclose a conflict of interest; or
> (4) an intentional violation of criminal law.[3]

7) Public Officer

[3] This language is drawn from Section 8.31(d), United States Model Nonprofit Corporation Act, Third Edition, 2008.

The current Act provides for what is called a "public officer" as a quasi-officer of the association. However, this office does not seem to be well defined. The duties of the public officer are scattered throughout the Act and include such things as:

- making filings with the Registrar [found in 9(2)(c), 17(2), 22(4) and 24(2)];
- accepting service of process under Section 27;
- they facilitate the inspection of certain records per 32; and
- opposing cancellation of the association's registration under 35.

Additionally, by common practice third parties (often including banks) interacting with an association often require the Public Officer to serve as the de facto signature authority for the entity.

The role and responsibilities of the public officer need to be better defined. However, this needs to be done in conjunction with better defining the role of the committee and its members as discussed above. If the Committee is to be subject to duties similar to a board of directors of a company, then there is a question as to what duties should be imposed upon the public officer. Is this person to be treated like a director, or are they more akin to being an officer of the entity, like a general manager, that is hired to implement the committee's policies? The answer to that initial question should determine the relative allocation of duties and responsibilities between the committee and the public officer.

If the public officer is empowered to act on behalf of their association in a prominent role, then it may be appropriate to impose similar duties upon a public officer as those placed upon the committee members, such as the duty of loyalty and the duty to disclose conflicts of interest. On the other hand, if there is to be a fully empowered committee with appropriate duties governing their actions, there is a question as to whether a public officer is even needed. There is no equivalent role for companies as they manage their affairs through their board,

8) <u>Powers of the Association</u>

The current Act contains two sections that list the powers it may exercise. Section 11 states that an association may hold, lease, mortgage or otherwise deal with land so long as its rules permit this. Then Section 20 sets out what are called the "General Powers of an Association" which contains a broader list of powers properly exercised by an Association. Finally, there are inherent limitations in the activities in which an Association may engage. Section 1, which contains the definitions to be used in the Act, makes clear that an association can only act in furtherance of charitable, religious or community-based ends, that any profits must be used towards only those ends, and that no member may receive any payments in the form of dividends from an association.

Unfortunately, these grants of authority leave unclear the status of activities in which associations might naturally engage. For example, can associations hire employees? Can they purchase motor

vehicles? Can they invest in stocks? The danger is that in listing certain powers of an association in the Act it implies that no other powers are available. For this reason, the powers of an association should be expanded to allow these entities to engage in *any* lawful activities so long as those activities are in pursuant of the allowable ends, meaning, chartable, religious or other community-based objectives.

9) Updating Model Rules

There are several advantages to requiring an association to have internal model rules, most notably that it brings certainty and transparency to the internal workings of the entity. To help achieve these ends, an argument could be made that prescribing a standard constitution in the regulations would be appropriate. However, taking this "one size fits all" approach may be too restrictive, especially considering that many religious organizations are incorporated as associations, and it may not be appropriate to compel these types of organizations to have a standard constitution.

The current Act strikes a middle ground. It contains an outline of the sorts of provisions that should be included in an association's model rules, but does not mandate how the provisions should read. This seems an appropriate stance and no changes are sought to this approach. A few minor changes to this outline are recommended for consideration, however, including requiring a statement as to how compensation is to be paid to committee members and the public officer.

10) How should meetings of an association be called? Should associations be required to have an annual meeting of the members?

The current Act does not specifically mandate that an annual meeting of the members take place. Section 22 contemplates that actions by the association shall only be taken pursuant to a special resolution passed in a "general meeting" of the members, which can be called at any time by giving 21 days advance notice. However, the Act does not specify who can call a general meeting (the committee only, or members?) and there is no definition of how such notice is to be given (newspaper? mailings?). Both of these points should be addressed.

Requiring an annual meeting to be held each year would ensure that members have an opportunity to meet with the committee each year in a formal setting to review the affairs of the association. But, an AGM could be dispensed with if all members concur.

11) There should be an annual filing required of all associations

There are two primary benefits to requiring an annual filing. The first is to provide the registry with accurate information as to what associations are active and which ones have ceased to exist. Currently there is no mechanism in place to determine if an association has ceased, and doubtless there are hundreds of associations shown as "active" on the register that are inactive. This is bad practice, and the AML guidelines speak against this situation.

The second reason to collect certain information about each active association so as to ensure that data held in the registry is accurate. The new amendments will require some biographical data about associations to be provided, such as key addresses. By requiring an annual filing this information is kept much more current than the current system in which this sort of information can quickly become dated as people tend to forget to make filings to update addresses.

One concern about imposing an annual filing requirement is that it imposes both an administrative and financial burden upon small entities. These are legitimate points. For this reason it is proposed that any annual filing be limited to a single page that is easily completed, and that only a nominal fee be imposed, if any.

12) Penalty provisions should be updated

The penalties in the current Act are so inconsequential that there is no incentive to comply with the law. Therefore, penalties should be increased to reflect today's economic realities. However, in order to protect smaller associations that may lack sophistication, for nearly all violations penalties should only be imposed after notice has been given by the Registrar that a violation may have occurred. The intent is to encourage compliance with the Act without unduly penalizing those who might not be aware of its mandates. Conversely, for violations that are done willfully or that have a criminal-like aspect, penalties should be more punitive.

13) Registration of Foreign Associations

The current Act does not contain provisions allowing for the registration of foreign entities that operate for chartable or religious purposes in PNG. This should be corrected and foreign entities should be registered and regulated in an analogous way as overseas companies are treated under the PNG Companies Act.

14) The Act should set forth in greater detail the role of the Registrar in administering the Act.

The Registrar has broad grants of authority to administer the Companies Act. Similar grants of authority should be considered for inclusion in the Associations Act. This point is underscored by the AML guidelines which seek a strong central authority to oversee the actions of nonprofit entities. For example, it might be appropriate to allow the Registrar to inquire concerning the financial affairs of certain associations to make sure that accurate records for donations are being kept and that these donations are being spent for proper ends.

CONCLUSION.

Stakeholder input concerning these changes is highly valued and will help shape any reform proposals that ultimately find their way into the proposed Associations Act amendment.