



Constitution for a Charitable
Company:
Practical Tips and Helpful Processes

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1. Introduction

The constitution is the fundamental document of a charitable company. It forms the basis of a company's charitable registration, determines its activities and governs the relations between its members and directors.

This paper explores the function of a constitution, considers some of its key features, including charitable objects, not-for-profit clauses and forward looking membership and governance structures, and provides some practical tips and helpful processes for those involved in the governance of a charitable company.

This paper focuses on the constitution of a company limited by guarantee that is registered as a charity with the Australian Charities and Not-For-Profits Commission (**ACNC**). When this paper refers to a constitution, it refers to the constitution of a company limited by guarantee registered as a charity with the ACNC. Likewise, when this paper refers to a charity, it refers to a company limited by guarantee that is registered as a charity with the ACNC.

2. The Legal Framework

A company's constitution has effect as a contract between:

- (a) the company and each member;
- (b) the company and each director and company secretary; and
- (c) the members.¹

The members and officers of a company are deemed to consent to the terms of a constitution when they become members or officers.

The contractual nature of a constitution provides flexibility to the members and directors of a company to tailor a constitution to meet their needs. However, like other contractual documents, a constitution is only valid to the extent that it is lawful. For example, a company cannot enforce a provision of its constitution if it is oppressive to, unfairly prejudicial to, or unfairly discriminatory against its members.²

The charitable constitution of a company limited by guarantee is subject to two main pieces of legislation:

¹ *Corporations Act 2001* (Cth), s140(1).

² *Corporations Act 2001* (Cth), s232.

1. the *Corporations Act 2001* (Cth) (**Corporations Act**); and
2. the *Australian Charities and Not-For-Profits Commission Act 2012* (Cth) (**ACNC Act**).

The *Corporations Act* adopts a more flexible approach towards charities than other companies. Section 111L of the *Corporations Act* provides that certain provisions of the *Corporations Act* do not apply to registered charities, such as:

1. the requirement to notify ASIC of a change to a company's constitution³;
2. the duties of directors⁴;
3. many of the procedural requirements for meetings⁵; and
4. many of the financial reporting and audit requirements⁶.

The *ACNC Act* and *Regulations*⁷ replace some of these provisions, such as the audit requirements⁸, with substantive provisions. However, other provisions are replaced with less restrictive guiding principles, contained in the ACNC Governance Standards.⁹ For example, members of a charitable company do not have a statutory right to appoint a proxy as section 249X of the *Corporations Act* does not apply to charitable companies. This means that charitable companies could provide in their constitution that members cannot appoint a proxy, which is the default provision under the NSW Fair Trading Model Constitution for incorporated associations. Alternatively, charitable companies could provide that members may only appoint other members as their proxies.

Another example of the greater flexibility provided to charitable companies is that they are not required to hold an annual general meeting as section 250N of the *Corporations Act* does not apply to charitable companies. Nevertheless, the ACNC expects that in most cases, a charitable company will follow the standard procedures set out in the *Corporations Act*. This is reflected in the ACNC template constitution for a charitable company limited by guarantee, which adopts as best practice, the procedures set out in the *Corporations Act*.

The *Corporations Act* requirements for holding general meetings no longer apply to registered charities. Instead, the ACNC's governance standard 2 requires registered charities to be accountable to their members. The steps that

³ *Corporations Act 2001* (Cth), s136(5).

⁴ *Corporations Act 2001* (Cth), ss180-183, 185.

⁵ *Corporations Act 2001* (Cth), Part 2G.2.

⁶ *Corporations Act 2001* (Cth), Parts 2M.1-2M.3.

⁷ *Australian Charities and Not-For-Profits Commission Regulation 2013* (Cth).

⁸ *Australian Charities and Not-For-Profits Commission Act 2012* (Cth), s60.30.

⁹ *Australian Charities and Not-For-Profits Commission Regulation 2013* (Cth), Division 45.

a charity must take to comply with this standard will depend on all of the charity's circumstances. The template constitution adopts many of the Corporations Act requirements that previously applied to registered charities (and currently apply to other companies), as they are well-known and understood practices for holding fair meetings of members.¹⁰

Another reason for this tendency to follow the *Corporations Act* could be the uncertainty that surrounded the ACNC in its early years with there being numerous calls to abolish the ACNC and repeal the *ACNC Act*.¹¹ Now that the ACNC is more established and seemingly here to stay, this is less of a concern. However, it is still possible that a charity may decide to discontinue its registration with the ACNC, such as if it determines that its main objects do not fall within the charitable purposes set out in the *Charities Act 2013*, and operate as a not-for-profit under the *Corporations Act* only. This is why many charitable constitutions include provisions similar to clauses 71.2 and 71.3 of the ACNC Template Constitution:

71.2. While the **company** is a **registered charity**, the **ACNC Act** and the **Corporations Act** override any clauses in this constitution which are inconsistent with those Acts.

71.3. If the **company** is not a **registered charity** (even if it remains a charity), the **Corporations Act** overrides any clause in this constitution which is inconsistent with that Act.

Charitable company constitutions are therefore governed by an interesting mix of contract and statute law.

3. Key Features

3.1. Charitable Objects

Similar to the way that the constitution is a charitable company's fundamental document, the objects clause is the constitution's fundamental clause. The objects set the parameters of a charity's activities and are the primary evidence considered by the ACNC when granting charity status and the ATO when endorsing a charity with tax concessions. In respect of the ACNC, this is reflected in the first Governance Standard:

¹⁰ *Guide to the ACNC's Template Constitution for a Charitable Company Limited by Guarantee*, ACNC, page 18.

¹¹ 'The ACNC has been spared!', Emil Ford Lawyers, <<https://www.emilford.com.au/charity-notforprofits/charity-notforprofit-articles/the-acnc-has-been-spared/>>.

A registered entity must:

- (a) be able to demonstrate, by reference to the governing rules of the entity or by other means, its purposes and its character as a not-for-profit entity; and
- (b) make information about its purposes available to the public, including members, donors, employees, volunteers and benefit recipients; and
- (c) comply with its purposes and its character as a not-for-profit entity.¹²

A charity should therefore interrogate its objects closely before it adopts its initial constitution and be wary of making changes to its objects. To be registered as a charity, a company's objects must fit within one of the charitable purposes set out in section 12 of the *Charities Act 2013*:

- (a) advancing health;
- (b) advancing education;
- (c) advancing social or public welfare;
- (d) advancing religion;
- (e) advancing culture;
- (f) promoting reconciliation, mutual respect and tolerance between groups of individuals that are in Australia;
- (g) promoting or protecting human rights;
- (h) advancing the security or safety of Australia or the Australian public;
- (i) preventing or relieving the suffering of animals;
- (j) advancing the natural environment;
- (k) any other purpose beneficial to the general public that may reasonably be regarded as analogous to, or within the spirit of, any of the purposes mentioned in paragraphs (a) to (j); and
- (l) promoting or opposing a change to any matter established by law, policy or practice in the Commonwealth, a State, a Territory or another country, if:
 - (i) in the case of promoting a change – the change is in furtherance or in aid of one or more of the purposes mentioned in paragraphs (a) to (k); or

¹² *Australian Charities and Not-For-Profits Commission Regulation 2013* (Cth), reg. 45.5(2).

- (ii) in the case of opposing a change – the change is in opposition to, or in hindrance of, one or more of the purposes mentioned in those paragraphs.¹³

On its website, the ACNC helpfully provides samples of objects that fit within each of the charitable purposes set out in section 12 of the *Charities Act*. For example, Example clause 6 of the Advancing social or public welfare example clauses provides:

The [organisation] is established to be a charity whose purpose is to advance social or public welfare by:

- providing care to people with a physical or mental disability who require continuous care
- providing respite care to people with a physical or mental disability who generally are cared for continuously by a family member , and
- arranging opportunities for people with a physical or mental disability to interact with other people and have the same life experiences as people who do not have a physical or mental disability.¹⁴

The sample clauses provide helpful guidance to charities seeking to ensure that their objects are consistent with charitable purposes.

In addition to having complying objects, charitable companies must ensure that their actual activities are consistent with their charitable objects. This is illustrated in the *Word Investments Case*, where the majority stated in relation to the *Income Tax Assessment Act 1997* (Cth):

Whether an entity is a “charitable institution” depends in part on its purposes and in part on its activities so far as they carry out those purposes; if its activities involve ceasing to apply its assets to the purposes for which it was established, it ceases to be a charitable institution.¹⁵

This important case is authority for the proposition that a charity may carry on a commercial activity where the activity and funds raised are carried out in furtherance of a charitable purpose. This case also illustrates the importance of alignment between a charity’s purposes and its activities and demonstrates that

¹³ *Charities Act 2013* (Cth), s12(1).

¹⁴ Advancing social or public welfare – example clause 6, <https://acnc.gov.au/ACNC/Publications/Templates/Example_CharitablePurpose.aspx>.

¹⁵ *Commissioner of Taxation of the Commonwealth v Word Investments Ltd* [2008] HCA 55 at [70] per Gummow, Hayne, Heydon and Crennan JJ.

if a charity's charitable status is in doubt, a court will carefully consider its activities.

3.2. Not-For-Profit and Winding-Up

The two other clauses of a constitution that are closely scrutinised by the ACNC are the not-for-profit and winding-up clauses.

"Not-for-profit" does not have a statutory definition and is therefore given its ordinary meaning. The ACNC describes a not-for-profit as:

an organisation that does not operate for the profit, personal gain or other benefit of particular people (for example, its members, the people who run it or their friends or relatives).¹⁶

The ACNC template constitution's not-for-profit clause uses the following language:

- 8.1. The **company** must not distribute any income or assets directly or indirectly to its members, except as provided in clauses 8.2 and 69.
- 8.2. Clause 8.1 does not stop the **company** from doing the following things, provided they are done in good faith:
 - (a) paying a member for goods or services they have provided or expenses they have properly incurred at fair and reasonable rates or rates more favourable to the **company**, or
 - (b) making a payment to a member in carrying out the **company's** charitable purpose(s).

Although charities need to be careful not to make payments that are inconsistent with their not-for-profit status, some charities take an overly cautious approach and adopt a blanket policy of avoiding all payments to members or directors. This sample clause illustrates that charities are permitted to pay members for services provided to the charity at fair and reasonable rates or make payments to a member in carrying out the company's charitable purposes. For example, a church would be permitted to provide food or small amounts of money to a member enduring financial hardship as this would be consistent with its charitable purposes.

¹⁶'Not-for-profit', ACNC, <http://www.acnc.gov.au/ACNC/Register_my_charity/Who_can_register/What_is_NFP/ACNC/Reg/NFP.aspx>.

Another consequence of a not-for-profit clause is that charities must be careful when accumulating profits or surplus from year to year. The ACNC provides the following guidance:

A not-for-profit can make a profit, but any profit made must be used for its purpose(s). It can keep profits as long as there is a genuine reason for this and it is to do with its purpose. For example, a good reason to keep profits may be to save up for starting a new project, building new infrastructure or accumulating a reserve so it continues to be sustainable.

If an organisation continues to hold onto significant profits indefinitely, without using them for its charitable purpose, this may suggest that the organisation is not working solely towards its stated charitable purpose (and is not operating as a not-for-profit).¹⁷

As this aspect of charity's not-for-profit status is usually not explicitly addressed in a charity's constitution, it is important that board members be aware of the need to question the accumulation of excessive surpluses.

The second aspect of a charity's not-for-profit status is the requirement to have a winding up clause that addresses the distribution of a charity's surplus assets if it ceases to exist. The ACNC template clause provides as follows:

- 69.1. Subject to the **Corporations Act** and any other applicable Act, and any court order, any **surplus assets** that remain after the **company** is wound up must be distributed to one or more charities:
 - (a) with charitable purpose(s) similar to, or inclusive of, the purpose(s) in clause 6, and
 - (b) which also prohibit the distribution of any **surplus assets** to its members to at least the same extent as the **company**.
- 69.2. The decision as to the charity or charities to be given the **surplus assets** must be made by a **special resolution** of members at or before the time of winding up. If the members do not make this decision, the **company** may apply to the Supreme Court to make this decision.

Charities that are endorsed as deductible gift recipients (DGR), or charities that operate a fund endorsed as a DGR, must have a winding up clause that provides that the surplus assets of the charity, or fund, in the case of a charity that operates a DGR fund, must be distributed to another charity endorsed as a

¹⁷ Ibid.

DGR. Those setting up a charity must therefore have a mind to succession planning at the outset. One of the circumstances in which this is an important consideration is where an existing charity establishes a separate charity endorsed as a DGR. If the DGR is subsequently wound up, the DGR's surplus assets would not be permitted to be distributed to the original establishing charity unless the establishing charity was also a DGR.

3.3. Membership

A constitution must appropriately accommodate the members of a company. It should address matters such as:

1. the process of applying for membership and approving applicants for membership;
2. the criteria for membership;
3. the different classes of membership, if any, and their associated rights;
4. whether there is an annual subscription fee; and
5. cessation of membership.

There are three common models of membership:

1. the closely held model;
2. the widely held model; and
3. the sole member model.

In the closely held model, there is a limited number of members, who usually also serve as the directors of the company. This model effectively gives all control to the board as the board controls who is appointed as a member and the members appoint themselves as directors. This model does not preclude a wider group of people being associated with the company, but restricts the company's voting power to a small group of people. The constitution may also impose limiting criteria on applications for membership. It may be necessary for a charity to consider whether the criteria imposed on applicants for membership constitutes unlawful discrimination. In NSW, section 57 of the *Anti-Discrimination Act 1977* provides a general exemption to discrimination law for the benefit of voluntary bodies that are carried on as not-for-profits but not every state or territory has such an exemption.

By contrast, the widely held model involves a large membership with directors being elected by these members. This model often involves the payment of an annual subscription fee as a condition of retaining membership, which is an easy way of generating funding for the charity. The wider membership base of this model necessitates a more democratic process for electing directors but, in many cases, the members will simply elect the directors nominated by the board.

Finally, some charities have another controlling charity as their sole member. Directors of the charity are therefore effectively appointed by the board of the sole member. In some cases, the same people will be directors of both the charity and the sole member. Instead of the charity holding member meetings, the board of the sole member can simply pass resolutions which have effect as a resolution of the charity. This structure can sometimes arise as the consequence of the merger of two or more charities as it can be simpler and cheaper to establish control of a charity, rather than transferring all assets over to the controlling charity.

3.4. Governance

To ensure good governance, the constitution should clearly set out the role of directors within the company, including:

1. the process of electing or appointing directors;
2. the term and rotation of directors (if any);
3. the composition of the board, including the minimum and maximum numbers of directors;
4. the qualifications of directors;
5. the office-bearers (if any);
6. the duties of directors.

Charities should consider how election processes, terms and rotation provisions will work practically and to account for the future administrative burden of such provisions. It is not uncommon to have quite complex rotation provisions which can create confusion and issues of non-compliance. For example, a constitution may provide for half of the board to retire every two years when, in practice, the board members of a charity instead stay on indefinitely without being re-elected. Sometimes a simpler approach is more appropriate, such as electing all directors at the AGM each year.

When drafting a constitution, charities should provide for the future circumstances of the company as well as its present circumstances. The present exception should not be the future rule. For example, some charities will establish with a CEO who also serves as a director. This may suit the charity in its early years such as where the CEO is one of the founders and initially serves in a voluntary capacity. However, a general principle of good governance in the not-for-profit sector is that the CEO, as an employee, should not also be a director. This does not stop the CEO attending board meetings by invitation but it helps avoid issues of conflict of interest.

Another vexed issue is the payment of fees to directors. Many charities are not aware that it is possible to pay fees to directors and retain charity status. The ACNC has recently published an opinion paper on the remuneration of charity board members, which clearly states that the ACNC allows payments to board members.¹⁸ However, charities should be aware that paying directors may have implications under other legislation. For example, section 150 of the *Corporations Act* permits a charity to apply to omit the word "Limited" from its name, provided that the company's constitution prohibits the company paying fees to its directors and requires the directors to approve all other payments the company makes to directors.¹⁹

Finally, the constitution is a valuable tool to educate and remind board members of their duties as directors. For this reason, some charities find it helpful setting out in full provisions that are dealt with in legislation and including a clause that identifies the duties of directors to the charity, even if those duties exist regardless of whether they are included in the constitution.

3.5. Dispute Resolution

It is now common to include a clause in a charity's constitution that sets out a dispute resolution process if disputes arise between members, directors, the board or any combination of these entities. This clause can be tailored to the needs and context of the charity. For example, the clause might specify a person holding a particular role within an associated organisation as the default

¹⁸ 'Remunerating charity board members: Information for charities about paying responsible persons for their duties', ACNC, <<http://www.acnc.gov.au/ACNC/Edu/Remunerating.aspx>>.

¹⁹ *Corporations Act 2001* (Cth), s150.

mediator if informal negotiation is unsuccessful and the parties to a dispute cannot agree on the choice of a mediator.

The aim of a dispute resolution clause is to avoid disputes within a charity proceeding to litigation as court proceedings are not well suited to resolving disputes within a charity and likely to incur excessive fees that would be better spent in pursuit of a charity's objects. Litigation is not well suited to addressing the relational aspects of a dispute and rarely leads to a restored relationship, whereas this is often one of the aims of mediation.

As a general principle, charities can be criticised for initiating litigation as it involves a drain on a charity's financial and human resources. This is illustrated by the closing remarks of Judge Hacon in the infamous English case of *NOCN (Formerly National Open College Network) v Open College Network Credit4Learning*, which involved a trade mark dispute between two charities:

I have one final observation which I think should be expressed even though it is self-evident. I now know that between them the parties, both charities, have incurred well over £400,000 on fees in this litigation. A very strong recommendation to settle at the case management conference was not taken up. The laudable cause of encouraging adult education will presumably have to endure an equivalent cut in funding solely because this dispute was not resolved at an early stage. Such an outcome is much to be regretted.²⁰

4. Practical Tips and Helpful Processes

4.1. Fundamental document but not a sacred text

A charity's constitution is an important document, but it is not a sacred text. A constitution should be a working document and should reflect the current needs and structure of the charity. If a provision is outdated or does not reflect the current functioning of a charity, the charity's board should consider amending the constitution. If a change to a charity's constitution is required for any reason, the board could at the same time consider other changes to the constitution, such as including a dispute resolution clause or updating any archaic language.

²⁰ *NOCN (Formerly National Open College Network) v Open College Network Credit4Learning* [2015] EWHC 2667 per Judge Hacon at [73]. For further reading see 'Trade Mark Disputes – where legal advice saves money', Emil Ford Lawyers, < <https://www.emilford.com.au/charity-notforprofits/charity-notforprofit-articles/trade-mark-disputes-where-legal-advice-saves-money/>>.

4.2. Not letting tax wag the dog

Tax is an important consideration for a charity, but charities should be wary of it becoming the primary consideration. Prior to seeking registration as a charity, founders should start with their objects and what they hope to achieve through their charity and then consider what tax concessions are available.

Some founders are driven by a perceived need to obtain DGR status. They fear that if they do not obtain DGR status, no one will support them! Some charities fit neatly into an existing DGR category. At other times, charities are able to frame their objects and activities in a way that convinces the decision maker to grant them DGR status, without changing the substance of what they do. However, from time to time, charities driven by DGR status can be forced to compromise or change the scope of their activities in order to qualify for DGR status. In these circumstances, charities should focus on their needs and objects before their tax eligibility because frequently, people will support a charity because they believe in its mission, even if these supporters do not receive a tax benefit for doing so.

It is also possible to operate as a not-for-profit without qualifying for registration as a charity or receiving income tax exemption, let alone DGR status. For example, some organisations do good work that benefits the community generally, without being eligible for tax concessions. These organisations may be able to divide their operations and apply for charitable registration of distinct aspects of their organisation. Even if they are unable to do this, not being a registered charity does not stop them from serving society. The ATO also permits some organisations to self-assess as income tax exempt.

4.3. Making the most of legal advice

It is possible to draft or amend a charity's constitution without obtaining legal advice and the ACNC template constitution for a company limited by guarantee is an excellent resource in this respect. However, like all templates, the template constitution should be adapted to meet a charity's unique circumstances and requirements. Legal advice can often be a valuable resource to charities that wish to customise their constitution and governance processes, but it is important that charities make the most of this advice.

If a charity does wish to engage a lawyer to assist with drafting or amending a constitution, it is often helpful to engage a lawyer at an early stage. Some charities try to minimise fees by modifying and adapting a template, such as the ACNC template, and then approaching a lawyer to ask them to sign off on their final version. Unfortunately, rather than saving fees, this can increase the fees that will ultimately be paid to a lawyer as the lawyer will need to carefully go through the changes to the template to remove inconsistencies and address changes that do not comply with the legal framework. A charity lawyer is also able to draw on their experience to provide feedback on the practical ramifications of a particular governance structure. Undertaking a “DIY” first and then approaching a lawyer also increases the length of the process and can lead to wasted board discussion on proposed provisions that are unlawful or impractical.

4.4. Retaining flexibility

To have an effective constitution, charities must balance the important safeguards provided by its constitution with the need for it to be a working document that does not unnecessarily constrain the ability of its board to operate. Charities should avoid unnecessarily creating red tape by requiring every decision or action by a board to be approved by the members. There are several areas where the role of safeguards must be weighed against the advantages of flexibility and board freedom, such as:

1. whether certain actions by the board such as the sale of property need to be approved in advance by the members;
2. the size of board and member quorums; and
3. term limits on board appointments.

Besides the limits of what is legally permissible, there is no right answer. As a general rule, it is helpful to consider whether a particular provision represents a change to the usual role of members and the board within an organisation. For example, requiring member approval for certain actions by the board may be an encroachment by the members on the usual role of a board. The members should therefore consider whether a particular safeguard is necessary or helpful. Boards are more effective when given sufficient freedom to carry out their role, subject to the member’s power to appoint and remove board members.

Similarly, imposing maximum limits on the length of time that board members can stay in office theoretically ensures that the board refreshes its composition at regular intervals to allow new energy and ideas to be injected into the charity. However, blanket rules such as this can cause the brilliant individual to be forced to move on before their time. The members therefore need to consider whether there should be exceptions to blanket rules.

4.5. Ensuring the members adopt the constitution

This final practical consideration is a simple one, but one that charities often get wrong. Section 136 of the *Corporations Act* provides that only the members can modify or adopt a constitution by special resolution, but the board often passes resolutions to modify or adopt a constitution at a board meeting without referring the resolution to the members. Such resolutions are ineffective at law. Rather, the board should pass a resolution to recommend a constitution for adoption by the members. The board must then notify the members of the resolution to adopt the new constitution at a members' meeting. The board must then hold the members' meeting and the resolution will be effective if passed by at least 75% of the members present and entitled to vote at the meeting.

It can be easy to blur the lines between the board and the members, especially in a closely held company where the same people constitute all the members and all the board members. However, even in these circumstances, the distinction should be upheld. This does not mean that the member and board meetings cannot be held on the same day and in the same place and immediately follow each other. Further, subject to the charity's constitution, the members can agree to waive or reduce the requirements for notice if all members agree before the meeting.

Finally, section 136(3) of the *Corporations Act* allows a charity's constitution to impose a further requirement in order for a special resolution of the members to have effect. For example, a constitution could provide that any special resolution to amend a charity's constitution must be approved in advance, or subsequently approved, by an external organisation.

4. Conclusion

A charity's constitution is an important document. It shapes the interactions between members and board members of a charity. When used to its full extent, the constitution of a charity provides important safeguards that protect a charity, educate and inform members and board members of their legal rights and duties and provides flexibility to assist a charity to adapt to meet changing circumstances.