Australia Council Submission to review of not-for-profit governance arrangements

About the Australia Council for the Arts

The Australia Council for the Arts is the Australian Government's arts funding and advisory body. Its mission is to enrich the lives of Australians and their communities by supporting the creation and enjoyment of the arts. This mission is underpinned by a commitment to:

- Excellent and distinctive Australian art - assisting Australian artists to create and present a body of distinctive cultural works characterised by the pursuit of excellence;
- Access for all Australians - assisting Australian citizens and civic institutions to appreciate, understand, participate in, enjoy and celebrate the arts;
- A strong and vibrant arts sector - providing infrastructure development for Australia's creative arts.

Overview of Not-For-Profit Arts and Culture Sector

Cultural organisations, which includes libraries, museums, performing arts organisations, and art galleries represent 1.9% of Australia's not-for-profit sector.

The Australia Council for the Arts has a detailed knowledge of the arts sector through its close relationships with arts organisations nationally. In 2010/11, we provided 1085 grants to arts and cultural organisations working across the fields of music, visual arts, literature and publishing, dance and theatre. These organisations are of varying size and are incorporated under ten different regulatory frameworks.

Governance Issues in the Not-For-Profit Arts and Culture Sector

The Australia Council for the Arts welcomes the Australian Government's goal to introduce smarter regulation, reduce red tape and improve the transparency and accountability of the NFP sector. Our experience in this area has shown that inadequate governance is often at the heart of organisations who struggle with delivering quality artistic outcomes and suffer from declining financial performance.

In the absence of a national regulator, the Australia Council has developed national standards for governance of arts organisations. These standards, which are based on the *ASX Corporate Governance Principles and Recommendations*, are laid out in the Australia Council publication *Essential Governance Practices for Arts Organisations.* We have included a copy of this document in our submission (see Attachment 1.) The framework outlined in the publication addresses many of the issues raised in the consultation paper. Of particular relevance, is the principles based approach provided by the "if not why not" disclosure regime in this framework.

Recommendations

We make the following recommendations and comments in implementing not-for-profit governance arrangements:

Augment existing laws

As far as practicable, the governance arrangements for NFP organisations should reference existing laws such as the Corporations Act and augment as appropriate for the NFP sector. The benefit of this approach is that the NFP governance requirements remain broadly synchronised with corporate governance and community expectations.

Principles Based Approach

We suggest a 'principles based' approach that allows flexibility for organisations to meet governance obligations which are appropriate to their size, situation and stakeholder expectations. The Australia Council requires larger arts organisations to report on governance arrangements in their published annual reports. These organisations are required to report against the Australia Council framework on an "if not why not" basis (similar to ASX corporate governance requirements). This regime provides both flexibility for the organisation and transparency for stakeholders.

Of particular concern is the suggestion in the consultation paper to mandate particular qualifications for board members. Small, regional or remote organisations report difficulties in attracting skills and expertise. The Australia Council has moved away from specifying expertise that boards should have (such as artistic, community financial, marketing, and legal expertise) and has instead stated that organisations should have competencies, skill-sets and experience on the board that enable it to discharge its mandate effectively.

Regulatory burden

The Australia Council supports the intent by the Australian Government to minimise regulatory burden for NFP organisations. However, until the state and territory governments harmonise their requirements with the national standards, additional red-tape requirements will remain an issue for organisations incorporated under state or territory legislations. Such organisations tend to be smaller and less able to manage their compliance obligations.

Essential governance practices

for arts organisations

Essential governance practices for arts organisations

Australia Council for the Arts
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Adapted with permission from *Corporate Governance Principles and Recommendations with 2010 Amendments, 2nd edition, ASX Corporate Governance Council.*

What's New

This document -

- adapts the 2nd edition of the *ASX Corporate Governance Principles and Recommendations with 2010 Amendments* for use by all arts organisations.

- replaces the *Major Performing Arts board (MPAB) Corporate Governance principles and good practice recommendations* which was based on 1st edition of the *ASX Corporate Governance Principles and Recommendations* published in 2003.

- creates a principle for promoting diversity and broadens the scope where the ASX guidelines include diversity in Principle 3. The Australia Council believes this change is more appropriate to the arts sector.

- complements the Australian Standard: Corporate governance - Good governance principles AS 8000-2003 published in June 2003.

Other resources

This document may be read in conjunction with other resources on the Australia Council for the Arts website which we hope will be useful for organisations. They are:

- *On board* is a short, easy-to-read guide to the basics of governance for arts organisations. It's a useful resource for those serving on boards and for staff of arts organisations who work closely with their chairs and board members.

  On board is written by David Fishel, one of Australia's foremost writers on governance for not-for-profit organisations. The booklet is an accompaniment to *The Book of the board: Effective Governance for Non-Profit Organisations 2nd edition* by David Fishel (Federation Press, 2008), which provides more detail on these and other topics of concern to board members and staff of non-profit organisations.

  http://www.australiacouncil.gov.au/research/arts_sector/reports_and_publications/on_board_serving_on_the_board_of_an_arts_organisation2

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Overview

"What distinguishes exemplary boards is that they are robust, effective social systems" Jeffrey Sonnenfeld

Good governance structures encourage organisations to create value (through entrepreneurism, artistic innovation, development and exploration) and provide accountability and control systems commensurate with the risks involved.

What constitutes good governance will evolve with the changing circumstances of an organisation and must be tailored to meet those circumstances. Best practice must also evolve with developments both in Australia and overseas.

Although the following best practice recommendations cannot, in themselves, prevent failure or mistakes in organisational decision-making, they can provide a reference point for enhanced structures to minimise problems and optimise performance and accountability.

Ultimately good governance is essentially about people working together effectively – especially so in the arts where board members are voluntary positions. Getting the best out of people is the way to make boards "great".

These principles and best practice guidelines will assist boards and board members of all arts organisations to ensure they meet their legal obligations. Incorporated associations and Aboriginal corporations should also check their legislation for specific legal requirements.

Essential Governance Principles for Arts Organisations has been adapted for use by all arts organisations from the 2nd edition of the *ASX Corporate Governance Principles and Recommendations with 2010 Amendments.*

Whilst these principles were adapted with larger arts organisations in mind, they can be applied in a similar manner (subject to scale) to smaller arts organisations. Even the boards of smaller organisations should be seeking to optimise performance and accountability in the interests of the organisation and its key stakeholders, such as government. However, if the board believes that a principle or recommendation set out below has no relevance to its organisation, or cannot be reasonably applied given the size or resources of the organisation, or wishes to implement a principle in a different way, the board should agree on that departure.

Note: In this document references to:

1. *"board" and "board members" also refer to the management committee and committee members of incorporated associations and Aboriginal corporations; and*
2. *"executive" can also refer to artistic director, chief executive officer, executive producer or general manager.*

Principles and recommendations

1. Lay solid foundations for management and oversight

Recognise the respective roles and responsibilities of board and management.

The board should:

- adopt a formal **charter** that details its principal functions and responsibilities

- approve a formal statement of **delegated** authority to management

- clearly delineate of the balance of **responsibility** between the chair and the executive

- provide input into the setting of the organisation's **strategic direction**, mission and vision

- **approve** the organisation's business strategy and performance objectives

- monitor implementation of the business, commensurate with the **risks** involved, and ensure appropriate resources are available and allocated appropriately

- ensure that the organisation has adequately documented its **key policies** (such as artistic policy, communications, marketing, fundraising, stakeholder/community relationships, governance, decision-making delegations, and financial management)

- consider, and have final approval of, the proposed **performance program and budget**

- receive and **review** regular comprehensive performance reports on all key business areas

- give prior approval to any material **capital expenditure**, or any material variation from budgeted or forecast expenditure

- provide an **induction** procedure for new board members ensuring all board members are made aware of their legal duties to act in the best interests of the organisation and the key terms and conditions relevant to that appointment

- ensure that the executive and senior management have **formal job descriptions** and a letters of appointment describing their term of office, duties, rights and responsibilities and entitlements on termination, if any

- establish a process for **evaluating** the performance of the executive and senior management, including the artistic director

- ensure no single individual has **unfettered powers**

2. Structure the board to add value

Have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties.

There should be:

- a clear **division** of responsibility at the head of the organisation - the roles of the chair and the executive should not be exercised by the same individual

- a **chair** responsible for leadership of the organisation's board, for the efficient conduct of the organisation board's functions and for the briefing of all board members in relation to issues arising at organisation board meetings

- effective **contribution** of all board members in meetings

- effectively review and challenge of the performance of management and exercise **independent judgment** by board members

- **constructive and respectful relations** between board members and between the board, the executive and management

- appropriate **competencies, skill-sets and experience** on the board to enable it to discharge its mandate effectively

- a **formal and transparent** process for nomination, selection and appointment of non-executive board members

- consideration given to the **optimum size** of the board which is conducive to making decisions expediently with the benefit of a variety of perspectives and skills

- leverage of board members experience and **networks**

- a majority of **independent** board members[1]

- specific **terms** for non-executive board members, subject to re-election. Reappointment should not be automatic. boards may wish to consider a maximum period of tenure for non-executive board members and a fixed period of appointment for board office-holders

- a process for **evaluating** the board's performance, collectively, and the performance of any board committees and individual board members

- access for board members to **continuing education** to update and enhance their skills and knowledge, relevant to the arts organisation and the board.

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[1] Refer to Appendix One for more guidance on assessing whether a board member is independent.

3. Promote ethical and responsible decision making

Clarify standards of ethical behaviour required of the organisation's board members and key executives and encourage observance of these standards.

The board should:

- set the ethical **tone-from-the-top** and standards of the organisation

- understand the **legal obligations and duties** of board members and management and the reasonable expectations of the organisation's stakeholders

- ensure senior management implement practices and exhibit **behaviours** consistent with the required standards

- approve a **code of conduct** for the organisation, which states the values and policies of the organisation, and complements the organisation's risk management practices. A code of conduct will only be effective if it is supported by appropriate training and monitoring of compliance with the code

- monitor and manage actual or potential **conflicts of interest** of board members, management or employees

4. Promote diversity[2]

Foster an organisational culture that embraces diversity.

Diversity includes, but is not limited to, Aboriginality[3], gender, age, ethnicity, disability[3] and cultural background.

The board should:

- Approve a policy[4] for the organisation concerning **diversity** and disclose the policy or a summary of that policy.

- Establish measurable objectives for achieving diversity[5]

- Assess annually both the objectives and progress in achieving them.

- Ensure that the organisation discloses in each annual report the measurable objectives for achieving diversity and progress towards achieving them.

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[2] ASX document includes diversity under principle 3.
[3] ASX guidelines do not include Aboriginality or disability.
[4] Refer to Appendix Two for more guidance on developing a diversity policy.
[5] This document broadens scope of diversity beyond ASX requirements which focus on gender diversity.

5. Safeguard integrity in financial reporting

Have a structure to independently verify and safeguard the integrity of the organisation's financial reporting.

The organisation's audit committee, if there is one, should:

- a **formal charter** and be of sufficient size, independence and technical expertise to discharge its functions effectively

- have audit committee members who are **financially literate**. The committee should include at least one member with **financial expertise** (as demonstrated by relevant qualifications and financial management experience at senior management level in the public or private sector). If there is no audit committee, then at least one non-executive board member should have financial expertise and the board should have processes in place that raise issues that would otherwise be considered by an audit committee

- appoint a qualified firm or individual to conduct an **annual audit** of the organisation's financial statements that is consistent with Australian accounting standards. Although not always legally required for smaller organisations, a properly conducted audit of the year's finances assists the board in their forward planning, gives valuable information to potential income sources (philanthropic foundations, private donors, sponsors, funding bodies) and generally lends credibility to the organisation

- on a regular basis consider the **independence, competence and effectiveness** of the external auditors and the implications for succession that may arise from that consideration

- **report** regularly to the board on matters pertaining to its role and function

The organisation's board, if there is no audit committee, should have board processes in place which raise issues that would otherwise be considered by an audit committee.

5. Recognise the legitimate interests of stakeholders

Respect and observe the legal and other obligations, including the rights of all legitimate stakeholders.

The board should:

- establish procedures to guide **compliance** with legal obligations (e.g., OH&S) and other stakeholder obligations such as to employees, clients/customers, governments and the community as a whole

- ensure the organisation's legal obligations to **government funding agencies** are met. The organisation's board should establish procedures to ensure timely provision of the required information, which includes the organisation's financial situation, its performance and its governance. The material should be factual, and presented in a clear and balanced way, i.e., disclosing both positive and negative information

- ensure it has an effective **communication strategy** for advising government funding agencies and other key income providers about any material

changes in the organisation's circumstances. Communications should be designed to enhance the precision of the funding agencies', or other potential fund raising targets, decision making processes

6. Recognise and manage risk

Establish a sound system of risk oversight and management and internal control. Organisations should design systems that identify, assess, monitor and manage risk.

The organisation should address risks that could have a material impact on its performance and business model (the organisation's "**material risks**"). These may include, but are not limited to, strategic risks, operational or artistic direction risks, funding risks, reputational or brand risks, compliance risks, environmental risks, human capital risks, financial reporting risks and arts sector-related risks, for example.

The board should:

- review the organisation's **policies on risk oversight** and management and satisfying itself that management has developed and implemented a sound system of risk management and internal control. The policies should cover oversight, risk profiling and assessment, risk management practices, compliance and control mechanisms and systems, and a review of the effectiveness of the risk oversight and management. When developing risk management policies, the organisation should take into account its legal obligations and also consider the reasonable expectations of its stakeholders.

- clearly determine and delegate the **roles and accountabilities** for risk management across the board and management. The organisation's board may wish to retain responsibility for risk management, or delegate it to the audit committee, if there is one. The ultimate responsibility for risk management rests with the full board, whether or not a committee exists to assist the board with its workload

- review the effectiveness of the organisation's implementation of its risk management system, particularly pertaining to material risks, at least annually, with adequate assurances from management. To assist this cause, the organisation's board should require the chief executive officer / executive, or equivalent, and chief financial officer / finance manager, or equivalent, to **attest to it in writing**:

  - whether all material risks are being **managed effectively**;

  - that the organisation's financial reports present a **true and fair view** of the organisation's financial condition and operational results and are in accordance with relevant accounting standards; and

  - that the organisation's financial reports are founded on a **sound system of risk management and internal control** and that the system is operating effectively in all material respects in relation to financial reporting risks

- ensure that it makes **additional enquiries**, where required, to satisfy itself that material risks and financial reporting risks are being managed effectively

- recognise the **inherent potential conflict** between the chief executive officer / executive, or equivalent, and artistic director, or equivalent, in managing day-to-day issues, establishing an appropriate system for controlling and managing risks and ultimately providing adequate management assurance on material risks, including financial reporting risks

7.   Remunerate fairly and responsibly

Ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to organisation and individual performance is defined.

The board should:

- adopt **remuneration policies** that attract and retain talented and motivated management and employees

- clearly establish the **structure of non-executive board members' remuneration**, where applicable for non-volunteer board members, from that of management remuneration

- have input into remuneration levels for the **executive**, or equivalent, the **artistic director**, or equivalent, and any executive reports whose responsibilities materially influence the organisation's artistic direction, strategy, operations and financial performance. Remuneration levels should be fairly based on arts sector and organisational-size references and designed motivate management and employees to pursue long term growth and success of the organisation

- ensure that no individual, either board members, if remunerated, or management, be directly involved in **deciding their own remuneration**

Appendix One: Assessing the independence of board members[6]

An independent director is a non-executive director who is not a member of management and who is free of any business or other relationship that could materially interfere with - or could reasonably be perceived to materially interfere with - the independent exercise of their judgement. Family or community ties and cross-directorships may be relevant in considering interests and relationships which may affect independence, and should be disclosed by directors to the board.

Office bearers (such as the board chair, audit committee chair or treasurer) should be independent board members.

When determining the independent status of a board member, the board should consider whether the board member:

1 is employed, or has previously been employed in an executive capacity by the organisation or another group member, and there has not been a period of at least three years between ceasing such employment and serving on the board;

2 has within the last three years been a principal of a material professional adviser or a material consultant to the organisation or another group member, or an employee materially associated with the service provided;

3 is a material supplier or customer of the organisation or other group member, or an officer of or otherwise associated directly or indirectly with a material supplier or customer;

4 has a material contractual relationship with the organisation or another group member other than as a board member of the organisation; or

5 is a substantial shareholder of the organisation or an officer of, or otherwise associated directly with, a substantial shareholder of the organisation.

The board should regularly assess whether each non-executive director is independent. Each non-executive director should provide to the board all information that may be relevant to this assessment. If a director's independent status changes, this should be disclosed in a timely manner to stakeholders.

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[6] From the 2nd edition of the *Good Corporate Governance Principles and Recommendations with 2010 Amendments,* ASX Corporate Governance Council, 2010

Appendix Two: Suggestions for the content of a diversity policy[6]

Organisations may find it useful to consider the following matters when formulating a diversity policy:

1. Commitment to diversity and articulation of the organisational benefits arising from employee and board diversity and the importance of benefiting from all available talent. This should promote an environment conducive to the appointment of well qualified employee, senior management and board candidates so that there is appropriate diversity to maximise the achievement of organisation goals.

2. Commitment to and identification of ways to promote a organisation culture which embraces diversity when determining the composition of employees, senior management and the board, including recruitment of employees and directors from a diverse pool of qualified candidates.

3. Identification of factors that should be taken into account in the selection processes and whether professional intermediaries should be used to identify or assess candidates.

4. Identification of programs that assist in the development of a broader pool of skilled and experienced board candidates including initiatives focused on skills development such as executive mentoring programs or more targeted practices relating to career advancement such as those that develop skills and experience that prepare employees for senior management and board positions.

5. Articulation of an organisation culture which not only supports workplace diversity but also recognises that employees at all levels of the organisation may have domestic responsibilities.

6. Transparency of board processes, review and appointments.

7. The extent to which the achievement of measurable objectives should be tied to key performance indicators for the board, the executive and senior management.

Where organisations establish a diversity policy, they should also introduce appropriate procedures to ensure that the policy is implemented properly, which may include additional measurable objectives in relation to other aspects of diversity as identified in the policy. There also should be an internal review mechanism to assess the effectiveness of the policy.