

SUBMISSION
to
The Treasury Review
of
Not-for-profit governance arrangements

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Introduction

We welcome this opportunity to comment on the Australian Government consultation paper into the *Review of not-for-profit governance arrangements*, dated December 2011.

This submission was prepared by Professor Anona Armstrong, Professor of Governance, Victoria Law School, and Mr. Steven Reynolds, a post graduate research student with 12 years senior experience in the not-for-profit sector. This submission draws on preliminary data analysed in furtherance of his unpublished thesis titled *Effective corporate governance in not-for-profit organisations*. This thesis is based on data accessed from 240 not-for-profit websites, an action research case study of an effective not-for-profit board and interviews with 5 not-for-profit experts, who combined, have in excess of 100 years of experience working with perhaps in excess of 6,000 not-for-profit organisations, depending on the extent to which each of the experts have dealt with the same not-for-profit organisation.

Generally we support an approach to governance which has high-level principles based mandatory requirements, as well as some good practice guidance centralised through the Australian Charities and Not-for-profit Commission (ACNC).

Broadly speaking we support the introduction of legislation that articulates mandatory governance duties as currently articulated in the current Corporations Act (2001) and the development of best practice guidelines adapted from the UK Governance Hub Publication *Good Governance Code for Voluntary and Community Sector* (2nd ed, 2010). Upon development of the Australian Good Governance Code for Not-for-profit Organisations we would then recommend an, *if not, why not* approach to reporting, similar to that adopted ASX listed companies in relation to the *Corporate Governance Principles and Recommendations 2nd Edition with 2010 Amendments* (ASX).

Similarly, we support the transition of governance requirements under Commonwealth powers to new uniform governance arrangements monitored and administered by the ACNC. We would generally support efforts by the Commonwealth Government to negotiate with States and Territories to ensure that the ACNC become the national regulator, having regard to the need for simplicity and cost effectiveness.

Care must be exercised by the ACNC to balance the new regulations with safeguards to ensure the continuation of opportunities for contributions to community social capital by volunteers and their many diverse organisations.

The following presents specific responses to the questions posed in the discussion paper.

1. Should it be clear in the legislation who responsible individuals must consider when exercising their duties, and to whom they owe duties to?

A legislated definition of who are responsible individuals and to whom they owe a duty is likely to be difficult due to the complexity and diversity of relationships which many not-for-profit organisations have with their office bearers, members, clients, community, etc. Obviously, the legislation should make it clear that the responsible individuals have obligations to act in the best interest of the organisation, and that NFP entities must be accountable to the independent body established by government.

2. Who do the responsible individuals of NFPs need to consider when exercising their duties? Donors? Beneficiaries? The public? The entity, or mission and purpose of the entity?

We recommend the legislation be extended to include the broader group of stakeholders, beyond the relevant members, as determined by the responsible individuals (board). Accountability for using resources efficiently and effectively is due to sponsors or donators but any decisions should remain with the board or office bearers.

We submit that the best practice principles could include an exercise by the responsible individuals (board) of defining who are their stakeholders and the results of this exercise should be published at least in the directors or annual report but preferably on the ACNA website.

3. What should the duties of responsible individuals be, and what core duties should be outlined in the ACNC legislation?

Based on the evidence from our research, from the experts interviewed and the action research case study, it would seem that the most board members would seem to largely understand the minimum legal duties expressed by common law fiduciary duties and the Corporations Act (2001) requirements.

Given, what we understand to be the intent to align the duties under the Incorporated Associations Act (Vic) with those in the Corporations Act in 2012 and the commonality between the duties expressed in the Corporations Act and common law fiduciary duties, we submit that the core duties of responsible individuals should be those as outlined in the Corporations Act (2001).

As noted in response to question 2, above, a duty of care would extend to stakeholders, such as for example, recipients of services by health service providers or sporting associations.

While there are differences between a duty and a role, nonetheless we see merit in not-for-profit boards defining and articulating their roles. Preliminary research undertaken by examining stated board roles in 56 annual reports of not-for-profit organisations published 2011 suggest that the boards themselves consider their roles to be those listed in Table 1.

Table 1. The roles of boards in Not-for-profit organisations

| Board Role | Explanation | Occurrence |
|--|---|-------------------|
| Strategy | Development, approval, monitoring, implementation | 75% |
| Oversight | Guides and monitors - of strategy, organisational performance, risk management, finances, compliance, external and internal environment | 75% |
| Finances | Including approval of budget, maintenance against insolvency, protecting the assets and investments | 63% |
| Organisational performance | Including specific programs, manage competently | 59% |
| Control / Compliance | Including with legal, ethical requirements, constitution, codes | 54% |
| Chief Executive Officer or Senior Management | Mentoring, supervising, hiring, firing, succession planning | 54% |
| Policy | Development of, approval of, monitoring | 46% |
| Governance | Establishing governance frameworks, Board effectiveness mechanisms | 46% |
| Risk Management | Including internal control, audit, risk identification, risk control, risk monitoring, risk reporting | 45% |
| Accountability | To stakeholders, defines stakeholders, communicate with, excludes Chief Executive Officer accountability | 29% |
| Ethics | Honesty, act in best interest of organisation | 25% |
| Mission, Vision, Values | Interpretation of, protection of, determination of, achievement | 18% |
| Leadership | Including directing | 14% |
| Provision of resources | Including advise to management, fundraising, protects, aligning | 11% |
| Reputation | Company announcements, protecting, annual reports | 11% |
| Transparency | Reporting, High Standards | 4% |

A divergence of views and lack of clarity concerning board roles is evident in the expert's opinions, with one expert noting that when we define board roles we need definitions which are "mutually exclusive but collectively exhaustive". This is problematic, as definitions of roles are unlikely to meet this criteria, insofar as for example, particular organisations may consider that oversight of the finances to be an oversight role or a finance role, similarly organizations may not necessarily note every duty, it may be, for example that 100% of boards considering monitoring the finances to be a core and self evident duty but not all choose to name it, because it is so self evident.

Furthermore, it is likely that depending on the stage and circumstances that the not-for-profit organisation finds itself, that particular roles may vary, for example the action case study data, accessed in the data gathering for the thesis suggested that board members could be less concerned with insolvent trading, for example in a situation where the organisation had built up significant cash reserves.

We submit that any good governance principles should encourage responsible individuals to articulate and communicate the specific roles that the board has defined for itself, beyond its statutory and common law duties.

4. What should be the minimum standard of care required to comply with any duties? Should the standard of care be higher for paid employees than volunteers? For professionals than lay persons?

We submit that the standard of care as defined in any legislation should apply equally to all responsible individuals, irrespective of their paid or professional status. The Courts, when assessing the application of the business judgement rule, penalties etc can and do exercise its prerogatives which may or may not be influenced by remuneration, professional status etc.

5. Should responsible individuals be required to hold particular qualifications or have particular experience or skills (tiered depending on size of the NFP entity or amount of funding it administers)?

In the data accessed from the unpublished thesis, there are limited instances in the annual report data to suggest that even with board members who are highly qualified in an academic sense, the organisation is failing and equally where the board members are not listed as holding any qualifications the organisation appears to thrive. Also in the annual reports of some remote location not-for-profit organisations, no qualifications are listed (noting that section 300B(3)(b) of the Corporations Act 2001 requires listing), presumably because obtaining certain representative qualifications or skill sets is likely to be difficult to obtain in those remote locations.

We submit that there is no particular qualifications, experience or skills universally conducive to good governance, except of course that responsible individuals should be honest, exercise due care etc. However, there is research into the desirable competencies of directors (See for example, Wan Yusoff and Armstrong 2010).

6. Should these minimum standards be only applied to a portion of the responsible individuals of a registered entity?

No, to do so would undermine the joint and several responsibility that all board members undertake.

7. Are there any issues with standardising the duties required of responsible individuals across all entity structures and sectors registered with the ACNC?

Difficulties can arise because of a lack of people to fill board positions in some locations and this results in one or two people filling a host of positions in a community. In other cases, people with experience may not hold “standard” qualifications. This issue can be addressed by guidance to boards to identify the expertise required by a board to fulfil a particular role and to appoint people with the desired expertise.

8. Are there any other responsible individuals’ obligations or considerations or other issues (for example, should there be requirements on volunteers?) that need to be covered which are specific to NFPs?

The National Safety Council case and the experience of one of the authors indicates that volunteers should have no lower standard of duties. People should not undertake roles for which they are not properly equipped to undertake.

9. Are there higher risk NFP cases where a higher standard of care should be applied or where higher minimum standards should be applied?

We submit that the answer is probably yes and that higher standard of care should be contemplated in the best practice guidelines. As indicated in the consultation paper, the standard of care and diligence would depend on the size, amount of public money received, qualifications and position on a board, and the risk attached to the entity’s activities.

10. Is there a preference for the core duties to be based on the Corporations Act, CATSI Act, the office holder requirements applying to incorporated associations, the requirements applying to trustees of charitable trusts, or another model?

See response to question 3, the application of the Corporations Act would be preferable.

11. What information should registered entities be required to disclose to ensure good governance procedures are in place?

As submitted above, we support the development of best practice guidelines adapted from the UK *Good Governance Code for Voluntary and Community Sector* (2nd ed, 2010). Upon development of the Australian Good Governance Code for Not-for-profit organisations we would then recommend an, *if not, why not* approach or system of reporting similar to that adopted ASX listed companies in relation to the *Corporate Governance Principles and Recommendations 2nd Edition with 2010 Amendments* (ASX).

We also consider that the publishing of a comprehensive Annual report, including a report of organisation performance against strategy and a Board performance against pre-agreed criteria be adopted. We also see merit in publishing a Board Charter and the Boards annual program of work. But again these should be viewed in the context of the good practice guidelines.

12. Should the remuneration (if any) of responsible individuals be required to be disclosed?

Yes, similar to that required by the AASB119.

13. Are the suggested criteria in relation to conflicts of interest appropriate? If not, why not?

Whilst not central to the thesis, the case study data and some of the experts interviewed, referred to potential difficulty in managing conflicts of interest. In three instances attempts at managing conflicts of interest caused some angst and disquiet. Equally, we recognise that absolute avoidance of conflicts of interest may not always be in the best interest of the organisation.

We submit that a duty to avoid conflicts of interest, rather than just manage them would be preferable. However, the legislation should recognize that in some circumstances even if one attempts to avoid conflicts they may still occur or be in the best interest of the organisation. How to respond to conflicts should be stated in the proposed guidelines.

14. Are specific conflict of interest requirements required for entities where the beneficiaries and responsible individuals may be related (for example, a NFP entity set up by a native title group)?

Recent court cases suggest that this is most desirable. We support the legislation suggestions put forward in Paragraph 126 of the consultation paper. A governance guidance manual (see Armstrong and Fitzpatrick 2008) could provide templates for disclosure/reporting and expected standards.

15. Should ACNC governance obligations stipulate the types of conflict of interest that responsible individuals in NFPs should disclose and manage? Or should it be based on the Corporations Act understanding of 'material personal interest'?

We support the Paragraph 126 in the consultations paper.

16. Given that NFPs control funds from the public, what additional risk management requirements should be required of NFPs?

We submit that the answer is probably that additional risk management requirements are required but should follow accepted practice for avoiding fraud and corruption. Mission drift could be addressed by disclosure requirements. These should be included in the best practice guidelines.

17. Should particular requirements (for example, an investment strategy) be mandated or broad requirements for NFPs to ensure they have adequate procedures in place?

Particular requirements are required but may not be appropriate depending on the size of the entity and its access to public money. These should be contemplated in the best practice guidelines.

18. Is it appropriate to mandate minimum insurance requirements to cover NFP entities in the event of unforeseen circumstances?

We submit that the answer is probably that minimum insurance is required but this should be contemplated in the best practice guidelines.

19. Should responsible individuals generally be required to have indemnity insurance?

We submit that the answer is probably that indemnity insurance is required but these should be contemplated in the best practice guidelines.

20. What internal review procedures should be mandated?

The Corporations Act (2001) makes provision for simplified requirements for small companies. We endorse the suggestions in Paras. 142 to 144.

21. What are the core minimum requirements that registered entities should be required to include in their governing rules?

The model provided by Consumer Affairs Victoria is appropriate for small not-for-profits. The adoption of the framework of the Corporations Act and the CATSI Act with “Replaceable Rules” or an “alternative” seems appropriate for larger entities.

22. Should the ACNC have a role in mandating requirements of the governing rules, to protect the mission of the entity and the interests of the public?

The determination of the mission and any changes in it or an entity’s performance indicators are the prerogative of the board of the entity. The ACNC as the regulator will be responsible for mandated rules as well as guidelines for best practice (See for Example, Armstrong and Fitzpatrick 2008).

23. Who should be able to enforce the rules?

The ACNC. Presumably the ACNC will monitor compliance with the regulations and have access to the information required.

24. Should the ACNC have a role in the enforcement and alteration of governing rules, such as on wind-up or deregistration?

Yes. The ACNC should have the required information through its regulation and monitoring activities.

25. Should model rules be used?

Model rules should be available. See the response to Para. 21.

26. What governance rules should be mandated relating to an entity's relationship with its members?

The rules of the Corporations Act or "Replaceable Rules" should be mandated. Depending on the size and risk, external auditing should be required.

27. Do any of the requirements for relationships with members need to apply to non-membership based entities?

All entities have stakeholders. Accountability and transparency are required in the allocation of monies provided by individual sponsors, the general public or the government.

28. Is it appropriate to have compulsory meeting requirements for all (membership based) entities registered with the ACNC?

All entities should hold an AGM.

29. Are there any types of NFPs where specific governance arrangements or additional support would assist to achieve in better governance outcomes for NFPs?

Web based information, guidelines, training manuals and templates could assist.

30. How can we ensure that these standardised principles-based governance requirements being administered by the one-stop shop regulator will lead to a reduction in red tape for NFPs?

Publish the annual report and corporate governance statement on the ACNC website and encourage potential funders, donees etc to access that ACNC website when making decisions. This should slowly transition to more transparent and accountable practices.

31. What principles should be included in legislation or regulations, or covered by guidance materials to be produced by the ACNC?

No further comment.

32. Are there any particular governance requirements which would be useful for Indigenous NFP entities?

No comment.

33. Do you have any recommendations for NFP governance reform that have not been covered through previous questions that you would like the Government to consider?

We note from the preliminary annual report data that transparency would not appear to rank highly on boards agenda. Furthermore, we note that only 55% of the 239 not-for-profit organisations examined published an annual report, and only 19% made a corporate governance statement, we submit a comprehensive annual report including a corporate governance statement ought to be made accessible not only from the not-for-profit organisation website but also from the ACNC listings. This we believe will lead to greater transparency of corporate governance arrangements and practices.

Whistleblower policies have been important in our discussions of avoidance of fraud in NGOs (See Francis and Armstrong 2011).

Relevant Publications From The Governance Program, Victoria Law School

- Armstrong, A. and Francis, R.D. 2011 Protecting the Whistleblower. Paper presented to the workshop “Whistleblower Protection” at the 28th International Symposium on Economic Crime “Responsibility for Risk”, Jesus College, University of Cambridge, 5-10 September 2011.
- Armstrong, A. and Francis, R. D. 2010 Ethical organizations: what hope is there? Paper presented to the LaTrobe University 13th International Conference on Corporate Governance, 7-9 April, Melbourne.
- Armstrong A. and Francis, R.D. 2009 Ethical dilemmas in the sustainability of non-profit organisations. Paper presented to the 23rd Annual Australian and New Zealand Academy of Management Conference, December, Melbourne.
- Armstrong, A. and Fitzpatrick, M. 2008 Excellence in Governance. A Guide for Victorian Industry Training Bodies. Skills Victoria, Melbourne.
- Francis, R.D. and Armstrong, A. 2012 (in Press) [The Meetings Handbook: formal rules and informal processes](#) London, Anthem Press.
- Francis, R.D. and Armstrong, A. 2011 Corruption and whistleblowing in international human aid agencies. *Journal of financial Crime*, Volume/Issue No. 18/4 Article No. 400557/140571
- Reynolds, S. *Effective corporate governance in not-for-profit organisations* Unfinished PhD thesis, submission 2012.
- Wan Yusoff, W. F. Armstrong A. 2010 Human Capital of company directors: A study of Malaysian public listed companies. 2nd International Conference on business, Technology and Engineering, IQRA University , Islamabad, 23-24 January 2010.