

Submission to the Commonwealth Treasury

Review of Not-for-profits Governance Arrangements

Consultation Paper December 2011

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Introduction

This submission addresses the release of the Commonwealth Treasury's consultation paper, *Review of Not-For-Profit Governance Arrangements* (December 2011). Some of the suggestions that have been provided in this submission are of a policy nature and support the need to introduce a flexible internal governance that may suit different types of not-for-profit organisations.

If any of the responses require further explanation please contact Dr Marina Nehme at m.nehme@uws.edu.au.

Observations

The consultation paper, *Review of Not-For-Profit Governance Arrangements* (December 2011), considers the core organisational governance principles that should apply to registered not-for-profit entities. The establishment of a flexible and efficient corporate governance is essential to ensure the accountability of such entities.

The observation made in this submission can be summarised in the following manner:

- Two main duties need to be imposed on responsible individuals and they are: the duty of care and the duty to avoid conflict of interest;

- Although the standard of care may vary depending on the qualification of the person, for example, a core objective test such as 'ordinary competency' may be required;
- The remuneration of responsible individuals should be disclosed;
- The ACNC should not have a role in mandating the requirements of the governing rules;
- the ACNC should not have a role in the enforcement and alteration of governing rules;
- The ACNC should not interfere in the internal management of the entity; and
- Indigenous people should have the choice to decide whether to incorporate their not-for-profit organisation based on the CATSI Act or the proposed legislation. Not-for-profit indigenous organisations should not be forced in the future to incorporate as registered entities.

Responsible Individual Duties

One of the considerations that needs to be taken into account when determining which duties may apply to responsible individuals relates to the fact that registered entities may have different structures. Further, some of the responsible individuals in the organisation may just be volunteers while others may be paid to take on such a role. Accordingly, there is a need to strike a balance between giving responsible individuals freedom to manage the affairs of the entity while holding them accountable for decisions made in conducting their work. Imposing a high burden may stop people from volunteering to take on such a role.

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

Specifying who the responsible individuals must consider may ensure that registered entities act as good corporate citizens. However the draw-back is that each entity may serve a different group of stakeholders. As such, it will be very difficult for a legislation to include all the different stakeholders that need to be considered by the responsible individuals.

Consequently, I propose that responsible individuals should owe a duty to their registered entity. This will indirectly involve the different stakeholders that may be affected by the registered entity. After all, the registered entity is there to provide a service to a group of people and it is that group that the responsible individuals should owe a duty to.

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

The group of people that the responsible individuals may need to consider will vary from entity to entity. As such, it may be impractical to specify to whom responsible individuals should owe a duty to.

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

Two main duties need to be outlined in the ACNC legislation:

- Duty to avoid conflict of interest: Responsible individuals should ensure that the interest of the registered entity does not conflict with their personal interest.
- Duty of care: Responsible individuals should be due diligent when conducting the affairs of the organisation.

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

A minimum standard of care may need to be imposed. Volunteers who are managing the organisation should also be held accountable and it is not acceptable to allow them to avoid liability just because they are not getting paid. However, the duty imposed on them should be reasonable and not excessive.

A core requirement should be imposed on all responsible individuals: They have to be involved in the management of the entity. This will ensure that volunteers consider whether they have the time and ability to fulfil their obligations adequately. If they do not, then they should not take part in the management of the organisation. This will likely improve the operation of the registered entity as only people who are willing to accept the duties imposed on them will join the management of the organisation.¹

What will constitute a breach of the standards of care and diligence in a particular case, may depend on a variety of matters, including the composition of the board, the qualification of the responsible individuals and the size of the registered entity.

¹ A S Sievers, 'What is the Future of Honorary Directors and Committee Members? Their Duties and Liabilities', Myles McGregor-Lowndes, Keith Fletcher and A S Sievers (eds), *Legal Issues for Non-Profit Associations* (LBC, 1996), 23.

However, a minimum core objective test such as 'ordinary competency' may be required.

5. Should responsible individuals be required to hold particular qualifications or have particular experience or skills?

No such requirement is needed. Imposing such a requirement may be too onerous.

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

The duty to avoid conflict of interest and the duty of care should be imposed on all responsible individuals of a registered entity as they are the foundation for the implementation of a good corporate governance structure.

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

If the only duties that are considered are the duty of care and the duty to avoid conflict of interest, there is no need to standardise such duties.² The duty to avoid conflict of interest is an essential requirement to protect an organisation, irrespective of its size.

Further, the duty of care is very important to ensure due diligence. However, this duty needs to be pitched at an appropriate level. Consequently, as long as the duty has a minimum standard (as noted in the response to Q 4), which allows flexibility, the duty of care should be applied to responsible individuals across all entity structures.

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?

No.

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

The minimum standard should always be in place. However, a higher standard may apply depending on the size, complexity of the registered entity and the qualification of the responsible individual.

² James Fishman and Stephen Schwarz, *Non Profit Organizations: Cases and Materials* (Foundation Press, 4th ed, 2010), 127.

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?

The core duties should be more akin to office holder requirements applying to incorporated associations. The core duties imposed on such officers ensure a balance between giving responsible individuals freedom to manage the affairs of the entity while holding them accountable for decision made in conducting their work. As such the duties will not be burdensome and unreasonable.

Disclosure Requirements and Managing Conflict of Interest

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

No comment. However it is important to note that the required information regarding financial reporting has to vary depending on the size of the organisation. One size cannot fit all in such a case.

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

Yes, the remuneration of responsible individuals should be disclosed to ensure transparency of the system.

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

I agree with the suggested criteria. They ensure that conflicts of interest are avoided or dealt with appropriately when they arise.

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)?

Such conflict of interest has to be disclosed to ensure accountability and the protection of all beneficiaries.

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'?

Stipulating the type of conflict of interest that responsible individuals should disclose and manage is too prescriptive and inappropriate. A similar approach to the one present in the Corporations Act is recommended.

Risk Management

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

No comment.

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

No comment

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

No comment

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

No comment.

20. What internal review procedures should be mandated?

The internal review procedures should be linked to reporting requirements. Such reporting requirements should vary depending on the size of the organisation as one size does not fit all.

Minimum Requirements for an Entity's Governing Rules

The internal governance rules of an organisation are those rules which regulate the activities of the organisation and the relationships within it.³ In the case of registered entities, these rules need to be flexible to allow the entity to adopt the rules that best suits its purpose.

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

The governing rules should be flexible. As such the core minimum requirement should not be too prescriptive. If the registered entity has members, the governing rules should be limited to:

- Membership qualification: This will include qualifications (if any) for membership of the registered entity;
- Fees: The entrance fees, subscriptions and other amount (if any) paid by the members of the registered entity;
- Object: The object of the registered entity has to be clearly stated in the governing rules;
- Members' liability: The liability (if any) of members of the registered entity to contribute to the debt of the organisation;
- Internal dispute: The procedure that has to be followed to remedy disputes between members and the registered entity should be set up in the governing rules;
- Management: The management structure of the registered entity should be set up in the governing rules. This will include any involvement of members in the affairs of the registered entity.

These are some of the key requirements that have to be decided on by the registered entity before it is created.

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?

No, the ACNC should not have a role in mandating the requirements of the governing rules. This should be left to the registered entity. The involvement of the ACNC should be minimal to that regard. This will ensure the flexibility of the system.

³ Robert Austin and Ian Ramsay, *Ford's Principles of Corporations Law* (LexisNexis, 14th ed, 2010), 187.

23. Who should be able to enforce the rules?

The rules should be a contract between:

- The registered entity and the members;
- The registered entity and its responsible individuals; and
- Members and members.

This will ensure consistency between the different legislations such as the CATSI Act, the Corporations Act and the Association Incorporated Acts.

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

No, the ACNC should not have a role in the enforcement and alteration of governing rules. This should be left to the registered entity and its members. Any involvement of the ACNC in the enforcement and alteration of governing rules may make the legislation inflexible and too prescriptive. Registered entities have to be able to change their rules when they see fit without getting the ACNC's approval. The ACNC should not interfere in the internal management of the entity. It may not have the resources to do this.

The regulator should be focused on ensuring that the registered entity and responsible individuals are complying with the statute. Further, having the power to enforce and alter the governing rules will not make much difference. For example, such a power to the Office of Registrar of Indigenous Corporations (ORIC) has not been very helpful to indigenous corporations.

25. Should model rules be used?

No, model rules should not be used. It should be up to each registered entity to create its own rules. The adoption of model rules may lead to inconsistencies in the governing rules. This is a problem that currently plagues the constitutions of indigenous corporations registered under the CATSI Act.

Under the CATSI Act, indigenous corporations cannot be registered without a constitution.⁴ Every indigenous corporation must have a constitution even if the corporation has adopted without modification all of the replaceable rules listed in the legislation.⁵ Model rules have been established by the Office of Registrar of Indigenous

⁴ *CATSI Act*, s 29-20.

⁵ *CATSI Act*, s 66-1(2).

Corporations and the adoption of these model rules by indigenous corporations has led to inconsistencies.

For example, the constitution of the Aboriginal Corporation for Sporting and Recreational Activities states that a person eligible to apply for membership of the corporation must be 'at least 18 years of age and an Aboriginal and Torres Strait Islander person'.⁶ Another provision of the constitution states that 'the directors must not accept an application if it results in a majority of members being non-indigenous'.⁷ Under the terms of the former provision, the scenario envisaged in the latter provision could not occur. This raises issues in relation to the way the constitution should be interpreted regarding eligibility for membership: must all members be indigenous or only a majority of members?

Many internal contradictions in the constitutions of indigenous corporations have been caused by the fact that a majority of indigenous corporations have created their constitution using an interactive computer program available on ORIC's website. This *Rule book—etool* is described as allowing users to 'click and type in modified rules, keep or delete irrelevant set law and produce printed or electronic copies of drafts'.⁸ While the program allows a corporation to make changes to particular provisions in the rule book, it does not identify for the user other provisions that may be incompatible with the changes proposed, and these provisions remain in the corporation's constitution. The fact that the Registrar has approved such constitutions indicates that the Registrar has not afforded those constitutions close scrutiny. At present it appears little consideration has been given to the impact such constitutional discrepancies may ultimately have on indigenous corporations.

Relationships with Members

It is up to each registered entity to define the type of relationship that it wishes to have with its members. This can be determined through the constitution of the registered entity.

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

No comment.

⁶ ORIC, *Aboriginal Corporation for Sporting and Recreational Activities: Rule Book* (18 May 2009), [5.2.2], <<http://www.oric.gov.au/document.aspx?concernID=100248>>.

⁷ *Ibid*, [5.2.4](d).

⁸ ORIC, *Rule book—etool*, <[http://www.oric.gov.au/Content.aspx?content=publications/ruleBook/rulebook-tool_help.htm&menu=start&class=start&selected=Rule book](http://www.oric.gov.au/Content.aspx?content=publications/ruleBook/rulebook-tool_help.htm&menu=start&class=start&selected=Rule%20book)>.

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

No comment

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

No, it is not appropriate to have compulsory meeting requirements for all (membership based) entities irrespective of their size. Such a requirement may be impractical and burdensome for some small organisation. The legislation needs to be flexible to that regard. For example, under the Corporations Act, only public company have a compulsory requirement to have a yearly annual general meeting.⁹ Proprietary companies do not have such a requirement.

Summary

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

Indigenous people should have the choice to decide whether to incorporate their not-for-profit organisation based on the CATSI Act or the ACNC legislation. It is important to remember that according to the Explanatory Memorandum to the Corporations (Aboriginal and Torres Strait Islander) Bill 2006 (Cth), the CATSI Act seeks to meet ‘the special incorporation needs of Indigenous people’ in a flexible legislative framework that allows corporations ‘to accommodate specific cultural practices and tailoring to reflect the particular needs and circumstances of individual groups’.

Further, the possibility that the proposed legislation may apply in the future to all not-for-profit indigenous corporations will make the CATSI Act obsolete as the majority of indigenous corporations registered under the CATSI Act (over 95%) are charitable or not-for-profit organisations. Consequently the compulsory application of the proposed legislation to all indigenous not-for-profit organisation may be viewed as a step backward as it goes against empowering indigenous people.

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?

That is a very good question. If the reduction of red tape does not occur, then the reason behind the proposed introduction of this legislation would have failed. For this

⁹ See for example, *Corporations Act*, s 250N.

reason, it is important to ensure that the proposed legislation is flexible. Such a flexibility may lead to the reduction of red tape.

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

No comment.

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

The legislation should be flexible. See response in Q 29.

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?

No.

Conclusion

Any proposed legislation that regulates not-for-profit organisations has to be flexible to allow not-for-profit organisations to run effectively. This will also help reduce red tape. However such flexibility need to be balanced with accountability. A strong accountability regime based on reporting has to be in place. Responsible individuals should also have certain obligation imposed on them such as the duty to avoid conflict of interest and the duty of care.

Further, the potential application of the proposed legislation on different entities such as indigenous corporations has major draw-backs. Indigenous corporations should not be regulated by such legislation as the proposed legislation does not take into account indigenous peoples' needs. A legislation that specifically empowers indigenous Australians to run their not-for-profit organisations based on their own customs and traditions should always be there. This will aid the government in closing the gap between indigenous and non-indigenous Australians by recognising their right to self-determination. The removal of such a right would be a step backward in such a quest.

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