

The Manager  
Philanthropy & Exemptions Unit  
Indirect, Philanthropy and Resource Tax Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

5 February 2013

Dear Sir/Madam

### **SUBMISSION – ‘DEVELOPMENT OF GOVERNANCE STANDARDS’**

I write to make a submission on the draft governance standards for charities, as set out in the recent Consultation Paper circulated by Treasury, ‘Development of Governance Standards’.

The key points of this submission (which are expanded on below) are that:

- The principle shortcoming of the standards is that their accountability functions are focused on members of charities and Not-for-Profits (NFP’s). Members are only one category of stakeholders in most of these entities and numerically and in most practical senses they are not the most important.
- The situation arises because the membership requirement of most charitable or NFP entities is one imposed by the forms of registration available - not the business needs or operational logic of the entities concerned.
- The unsuitability of existing forms of registration has been well-recognised in previous and ongoing inquiries by governments. The most effective remedy would be one that addressed the root causes of that unsuitability. These causes have been identified as the concentration of management power in a single Board and the insufficient accountability of that Board to the entity’s stakeholders.
- The terms of reference of the current consultation do not permit consideration of a solution which addresses these root causes. That being the case, the best solution appears to involve (i) a change in the wording of Standard’s Two and Four to shift the emphasis in accountability from ‘members’ to ‘stakeholders’ and (ii) the addition of a Note to the amended Standards, emphasising the capacity of registered entities to use the flexibility contained in their governing documents to design new accountability mechanisms that suit their specific and particular accountability requirements.
- More generally, without meaningful capacity on the ACNC’s part to actively measure the compliance of individual registered entities with their purposes and these Standards and hold managements accountable for same, the proposed Standards risk representing a charade of accountability rather than its meaningful achievement.

I write in my capacity as a consultant within the not-for-profit community sector who has worked extensively with small-medium sized, community-based charitable or NFP entities in three states. Entities in this sub-sector tend to have the following features in common:

- They are community-based (in either a locational community or a community of interest);
- They provide a range of community services including cultural and arts development, family support, early childhood education and care, environmental protection and conservation, community development, disability services, community media, emergency relief, advocacy and community education activities, humanitarian settlement programs, et al;
- They are predominantly incorporated associations established under state legislation although increasing numbers are registering as public companies limited by guarantee;
- The majority were established as the result of community activism in the second half (and particularly the final quarter) of the last century;
- Most were initially self-funding but (since the 1980's in particular) they have become increasingly dependent on government funding to the point where many of them are non-government organisations in name only. That is, not autonomous or sustainable without such income support;
- They are increasingly dominated at senior levels by a culture of professionalised management with weaker connections to the 'founding cause' than earlier generations. However individual organisations retain strong roots in their communities especially in regional areas;
- As a combined result of these factors, many organisations in this sub-sector are less dependent on community engagement and membership support for their legitimacy and more on their capacity to meet the service delivery objectives of their key stakeholders – particularly funding agencies, employees and beneficiaries.

I have taken the approach in this submission of seeking to test firstly, whether the Draft Standards meet the statements of intention and purpose which are described on page six of the Governance Standards Consultation Paper<sup>1</sup> in the following terms:

- The governance standards are intended to reflect a minimum set of outcomes for registered charities, rather than mandate 'best practice governance'...
- The purpose of these standards is to ensure all stakeholders can be confident that a minimum standard of governance is being met across all charities, whilst providing entities with sufficient flexibility to determine how they go about managing the charity and how to advance the charity's purposes... **These stakeholders include the broader Australian community, those who benefit from the important services provided by NFP's and those who work or volunteer for a charity.** *[my emphasis]*

And secondly, I have sought to test whether the Standards meet the needs of the organisations I work with for governance arrangements that offer all their stakeholders some measure of control over the managements of these entities (which is the ultimate objective of accountability).

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<sup>1</sup> p. 6, 'Development of Governance Standards: Consultation Paper' (2012) Source: The Australian Government the Treasury

I have done this with reference to my own experience and the evidence of previous parliamentary and other inquiries into the matter of stakeholder and shareholder engagement, a number of which are cited in what follows. My responses do this by way of answers to the questions posed by the Consultation Paper.

### **1. Does Draft Standard One establish appropriate principles?**

- 1.1. The Standard requires registered entities to demonstrate their purposes and character as a NFP entity and comply with those purposes and character.
- 1.2. In my view, this objective would be strengthened if, in addition to requiring that the entity demonstrate its purposes and character as a NFP entity “*by reference to the governing rules*”, entities were also required to make those governing rules (usually the Constitution) readily available – for example, on their website.
- 1.3. Making the governing rules highly accessible would assist stakeholders to make their own judgements about whether the rules are likely to work (or do actually work) to promote the achievement of the entity’s stated purposes. I am aware of registered entities with rules that entrench the power or interests of sectional interests. Scrutiny of the rules which permit this may assist stakeholders to restructure the entity to promote the access to decision-making of all interests and stakeholders.
- 1.4. Making the governing rules readily accessible also minimises the opportunities for managements to frustrate requests for access to those documents.
- 1.5. This additional requirement of registered entities, while inconsistent with Treasury’s preferred approach, will strengthen their accountability by facilitating stakeholders’ understanding of the Constitutional mechanisms which govern how the entity pursues its objects.

### **2. Is the wording of Draft Standard One appropriate?**

- 2.1. Re-wording the Draft Standard to require charities and NFP’s to lodge their governing documents for exhibition and download via the ACNC’s web-based search facility as a condition of registration, would address this concern.

### **3. Does Draft Standard Two establish appropriate principles?**

- 3.1. The principles which Draft Standard Two establishes address the primary governance objective of accountability.
- 3.2. The principal shortcoming of the approach which the Draft Standards take on this matter is that the Standard as drafted focuses exclusively on accountability to members.**

3.3. This represents a significant shortcoming in that:

- 3.3.1. The membership of many charities and NFP's amounts to a vestigial rump, numbering only as many members as are on the Board or a slightly greater number.
- 3.3.2. Members are only one category of stakeholders in most charities and NFP's. Numerically - and in most practical senses – they are not the most important.
- 3.3.3. The range of stakeholders not considered as a result of this oversight includes classes acknowledged in the Consultation Paper as the broader Australian community, beneficiaries and staff (paid and volunteer). Elsewhere in the Paper they are itemised as including donors – but they might also include (without being limited to) funders; other charitable entities; partner agencies; the communities in which the entity operates; agencies of government, including regulators; and suppliers and re-sellers, especially for social purpose businesses.
- 3.3.4. A fundamental principle of sound corporate governance is that accountability is owed to all stakeholders in some sort of proportion to their stake in an entity.
- 3.3.5. The interests of the stakeholder groups itemised at 3.3.3 are not acknowledged let alone secured by the measures proposed. This is at odds with Treasury's and the Commission's statement that the purpose of the Standards is to ensure that "*all stakeholders can be confident that a minimum standard of governance is being met across all charities*"

**3.4. The situation arises because the membership requirement of most charitable or NFP entities is one imposed by the forms of registration available - not the business needs or operational logic of the entities concerned.**

- 3.4.1. This is particularly true for public companies Limited by Guarantee regulated by the *Corporations Act 2001*. The Act contains provisions regulating members' rights and powers which are more restrictive than equivalent provisions in state-based incorporated associations' legislation.
- 3.4.2. Nevertheless it is also still true for the many entities which begin life as community-based incorporated associations. They owe their corporate existence to the shared passion for a cause which animates the initial membership base. However many of the same entities, once they become caught on the flypaper of funding or regular income from some other source, lose that animating 'fire in the belly'. They retain a membership because it is a condition of registration as an incorporated association. But the role of those memberships over time becomes more and more restricted as staff and management committees feel increasingly accountable to funding agencies or sponsors rather than their members. The meaningfulness of membership has shrunk in that the entities being described here can offer members less and less in

terms of meaningful opportunities to shape what the entity does, beyond a helping role as unpaid labour in a voluntary capacity (including as members of the Management Committee). As such, the ‘value proposition’ of membership is unclear in many organisations.

3.4.3. Some locality- and cause-based NFP’s and charities do retain comparatively large and active memberships. However it does not automatically follow that an engaged and activated membership is the indicator of effective management accountability practices.<sup>2</sup> Nor does it follow that the existing accountability mechanisms established for membership-based entities facilitate quality management or accountability outcomes.

**3.5. The unsuitability for charities and NFP’s of existing forms of registration has been well-recognised in previous and ongoing inquiries by governments.<sup>3</sup>**

**3.6. The most effective remedy would be one that addressed the root causes of that unsuitability. These causes have variously been identified as the concentration of management power in a single Board and the insufficient accountability of that Board to the entity’s stakeholders.**

3.6.1. The forms of registration available to charities and NFP’s are ill-suited to their real needs because those forms have their origins in law designed to facilitate the activities of profit-making entities.

3.6.2. The privileged position of members in public companies reflects the long evolution in common law and statute of an understanding of that pre-eminence based on members’ ownership of an equitable stake in the company. This stake is held by the

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<sup>2</sup> For example: <http://newmatilda.com/2010/02/22/without-trees-no-forest> ; <http://newmatilda.com/2010/02/18/cant-see-forest-for-trees> These reports document a case study within The Wilderness Society. The comments threads following the reports illustrate the competing and often irreconcilable interests of different stakeholder groups in the one entity and the challenge to directors of trying to balance these in meeting their accountability obligations.

<sup>3</sup> Previous public inquiries which have considered the broader issues of accountability in public companies include the Parliamentary Joint Committee on Corporations and Financial Services’ Report on the *Company Law Review Bill 1997* (with Senator Andrew Murray’s accompanying Minority Report of March 1998); the Joint Committee’s Inquiry into shareholder engagement and participation, *‘Better Shareholders – Better Company’* of June 2008 (which references Senator Murray’s then-recent discussion paper, *‘A proposal for simplifying the legal form and regulation of small for-profit and not-for-profit entities’*); and the current Corporations and Markets Advisory Committee (CAMAC) inquiry into *‘The AGM and shareholder engagement’*. These inquiries have focused on the effectiveness of existing accountability mechanisms (like members’ meetings, particularly the AGM, statutory disclosures and voting procedures) for facilitating effective shareholder oversight of company managements. Submissions to – and sometimes the findings of - these inquiries (including the introduction of electronic voting and splitting the reporting and decision-making functions of the AGM) have generated worthwhile suggestions for improvement which might have applicability to non-shareholding based public companies. However with the exception of Senator Murray’s contributions in dissent, most of these inquiries have either seen the situations that confront NFP’s working within public company structures (or their state-based equivalents) as beyond their remit or acknowledged the difficulties arising for entities in those situations but referred any investigation of them to future inquiries. The Government did announce in the 2011-2012 Budget that a review of the Company Limited by Guarantee structure and its continuing appropriateness for NFP’s would be undertaken and a Consultation paper was promised in early 2012 (although it does not appear to have been released). At a Consultation conducted by the Commission and other Australian Government officials in Sydney on 30 January 2013, a Treasury official confirmed this review was ongoing but was unlikely to have ramifications that would seriously change the nature of this form of registration.

investor in order to obtain a 'share' of any profits earned by the entity using the investor's capital contribution.

3.6.3. The Report of the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into shareholder engagement and participation, '*Better Shareholders – Better Company*' (2008) noted, of the existing governance model for public companies, that the model recognised the impracticality of management by shareholders "*but ensures that those responsible for the company's performance and direction are accountable to the owners of the company for the decisions they make on their behalf. [2.3]*"<sup>4</sup>

3.6.4. The "existing governance model" referred to establishes member pre-eminence, in part, by distinguishing between control and ownership. Control is exercised by management in the form of directors acting as a Board (s 198 *Corporations Act 2001*). Ownership belongs to the members (shareholders) by virtue of their investment in the entity. Management are accountable for the exercise of their decision-making power to member/owners (usually in general meeting but also via statutory reports and in other ways). The *Corporations Act* reserves a limited range of decision-making powers to members (e.g. the capacity to appoint or reject directors) and there is scope for these to be varied by the corporate Constitution.

3.6.5. The meaningfulness of the accountability identified by the Joint Committee in its Report has subsequently been disputed<sup>5</sup>, particularly for members of companies limited by guarantee and incorporated associations who do not have an equitable stake in the companies of which they are members.

### **3.7. The terms of reference of the current consultation do not permit consideration of a solution which addresses the root causes of the unsuitability of the existing forms of registration for charities and NFP's.**

<sup>4</sup> p. 3, '*Better Shareholders – Better Company: Shareholder engagement and participation in Australia*' (2008) Parliamentary Joint Committee on Corporations and Financial Services, accessed at [http://www.aph.gov.au/Parliamentary\\_Business/Committees/Senate\\_Committees?url=corporations\\_ctte/completed\\_inquiries/2008-10/sharehold/report/index.htm](http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=corporations_ctte/completed_inquiries/2008-10/sharehold/report/index.htm)

<sup>5</sup> For example, former Senator Andrew Murray's concern, explored in his Minority Report on the Company Law Review Bill 1997 (1998), with the concentration (and relative unaccountability) of powers exercised by directors in the Board. [Heading 5.1, Senator Andrew Murray, Minority Report, Report on the Company Law Review Bill 1997 (1998) Parliamentary Joint Committee on Corporations and Financial Services, accessed at [http://www.aph.gov.au/Parliamentary\\_Business/Committees/Senate\\_Committees?url=corporations\\_ctte/completed\\_inquiries/1996-99/companylaw/report/d01.htm](http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=corporations_ctte/completed_inquiries/1996-99/companylaw/report/d01.htm) ] Senator Murray's suggestion was the separation of management (operational) and governance (accountability) responsibilities, a separation he likened to 'a corporate senate'.

*The distinction is between a body that conducts the normal operational and managerial functions of a Board, and another body which deals with accountability issues... There are significant deficiencies in the method of controlling companies and of ensuring full accountability to shareholders... A sure way to increase the independence and accountability of Boards is to have two Boards, one concerned with managerial issues and one concerned with governance issues. The former should quite properly continue to have directors elected relative to shareholdings but to protect minorities, minimise conflicts of interest issues, avoid Board 'capture' and ensure accountability, the latter needs to be elected by shareholders.*

**3.8. That being the case, if the objective of the Draft Standards is to promote accountability, the pressing needs are to establish (i) to whom accountability is owed and (ii) the mechanisms that meet this accountability obligation which are both effective (from the point of view of those to whom accountability is owed) and efficient (from the point of view of management).**

3.8.1. It is my argument that the obligations of accountability in many charities and NFP's are not pre-eminently to the membership, on the basis that numerically and in terms of their stake in the entity the claim of members is not necessarily the most significant. (Although members may still be a significant category of stakeholder given the entity's structure and operations).

3.8.2. Since the directors cannot 'own' a charity or NFP directly, (because they are prohibited from distributing profits to members as proprietary and other public companies do), accountability must be owed to as yet unidentified stakeholders, all of whom are likely to have quite specific accountability requirements.

3.8.3. The '*Better Shareholders*' Report provides the basis for one response to the challenge of determining to whom accountability is owed.

***The critical nexus between these decision-making and accountability functions is engagement between shareholders and the company board that is informed, meaningful and effective. [my emphasis] Evidence received by the Committee suggested that participation and engagement with company boards is an important means by which shareholders are able to improve the value of their share ownership and minimise risk... [2.7]<sup>6</sup>***

3.8.4. If the Report's point about a "critical nexus" is accepted and the word 'stakeholders' is substituted for 'shareholders' then a meaningful framework for management accountability in stakeholder-based charities and NFP's starts to emerge. (For the purposes of this exercise, stakeholders would include - but not be limited to - those itemised at 3.3.3 above.) Substituting the word 'stakeholder' for 'shareholder' allows a reader to retain the sense of the relationship between the parties, the character of the obligations which are owed by the directors and the operation of the accountability mechanisms by which those obligations are met.

**3.9. This being the case, in what ways might the responsibility for these accountabilities be met by responsible entities and Boards?**

3.10. The '*Better Shareholders*' Report identifies what the Joint Committee believes are the key success factors associated with "*[stakeholder] engagement and participation that contributes to good corporate governance*":

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<sup>6</sup> pp. 3-5, '*Better Shareholders – Better Company: Shareholder engagement and participation in Australia*' (2008) Parliamentary Joint Committee on Corporations and Financial Services.

*[1] [stake]holders being well-informed about the companies in which they [have a stake] through effective communication; that is, **transparent reporting of company information and meaningful dialogue between [stake]holders and company boards** [my emphasis]; and [2] [stake]holders being able to perform their accountability role by exercising their voting rights effectively. [2.9]<sup>7</sup>*

- 3.11. Appropriate forms of ‘effective communication’ are itemised in Treasury’s Consultation Paper as including ‘*such matters as the quorum required for a meeting of members, the frequency of members meetings, providing notices of member meetings, voting and allowing members to ask questions at meetings*’<sup>8</sup>. Formal reports on the previous year’s activities, the obligation to maintain documentary records and voting by members on the basis of reports are all forms of accountability with their origins in the *Corporations Act*.
- 3.12. Meetings and minute-keeping are useful as elements of a portfolio of activities which might meet the directors’ accountability responsibilities. However my experience of members’ meetings is that for the most part they are a *pro forma* exercise, conducted annually because they have to be and without any meaningful reflection on the purpose or objective of the exercise. Nowhere is this more apparent than in the presentation of the financial reports. Having also seen audited financial statements unravel when subjected to more intense and knowledgeable scrutiny, I am not confident that having financial reports audited is a sufficient guarantee of the integrity of their conclusions.
- 3.13. As such, measures like meetings in which directors account, *post-facto*, for their management of the entity in the preceding 12 months using carefully crafted reports to communicate their message, may be poorly suited for securing genuine accountability and transparency for the range of stakeholders who, in NFP’s, represent the more important stakeholders in the entity<sup>9</sup>.
- 3.14. It follows from this that merely enabling voting by non-member stakeholders based on such reports is not prospective for assisting them to hold the entity’s management

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<sup>7</sup> p. 5, ‘*Better Shareholders – Better Company: Shareholder engagement and participation in Australia*’ (2008) Parliamentary Joint Committee on Corporations and Financial Services.

<sup>8</sup> p. 13, ‘*Development of Governance Standards: Consultation Paper*’ (2012) Source: *The Australian Government the Treasury*

<sup>9</sup> Moreover effective communication with stakeholders is not simply about their capacity to hold managements accountable. There is also the significant potential for value-adding in its own account which communication with critical stakeholders can bring. As one respondent noted in their submission to the 2007 Parliamentary Joint Committee inquiry into shareholder engagement [Dr. Shann Turnbull, accessed at p. 8:

[http://www.aph.gov.au/Parliamentary\\_Business/Committees/Senate\\_Committees?url=corporations\\_ctte/completed\\_inquiries/2008-10/sharehold/submissions/sub23.pdf](http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=corporations_ctte/completed_inquiries/2008-10/sharehold/submissions/sub23.pdf) ]:

*The very existence, as well as the competitive standing of any business, depends upon its relationships with its strategic stakeholders such as its **employees, customers and suppliers**. [my emphasis] Unlike shareholders, who can walk away from the company by selling their shares, many strategic stakeholders have long term commitments. In addition, they will possess what ‘independent’ directors must by definition lack, that is, business specific inside knowledge and experience. Strategic stakeholders are not only in the best position to advice [sic] shareholders but are by definition the most vital resource for sustaining the company and its competitive advantages. It is very much in the self-interest of investors, directors and management to develop a constructive involvement with their strategic stakeholders’*

accountable<sup>10</sup>. As such, accountability mechanisms taking the form of direct discussions between directors and stakeholders may be more appropriate.

- 3.15. For example, institutional shareholders in public companies limited by shares communicate frequently and relatively informally with company managements in investor briefings. Equivalent forums already operate for significant stakeholders and NFP company managements: relationships in which high levels of access to senior decision-makers are guaranteed in proportion to the significance of the stake which a third-party has in the entity. Funders, for example, usually have ready access to managers and management committees, as do sponsors and significant donors.
- 3.16. How should responsible entities engage more actively with stakeholders? The simplest solution for *'transparent reporting of company information and meaningful dialogue between [stake]holders and company boards'* requires entities to identify who their stakeholders are; clarify the nature and significance of that stake in the entity's success; and design accountability mechanisms which acknowledge the significance of each stake while simultaneously preserving – for reasons of compliance with the law – an overriding accountability for the organisation's Board or Management Committee.
- 3.17. Such arrangements can facilitate informal but effective communications (measured in terms of both parties achieving their objectives for such processes). The principal risk in informal arrangements is to transparency (i.e. are one set of stakeholders getting privileged information which other stakeholders - without the same level of ready access to management - are not receiving?). In these situations, there are arguments for formalising the engagement process and the opportunities for stakeholder input into management decision-making, especially with larger entities.
- 3.18. As Dr. Shann Turnbull noted in a submission to the Joint Committee's 2007 investigation:

*To allow strategic stakeholders to maximise their ability to reduce risks and add value, they need a forum to develop and share knowledge, independently of management. This can be provided through the corporate constitution making provision for stakeholders to appoint their own advisory councils. In this way, shareholders and directors would establish a process for obtaining inside, expert information, independent of management, on the health and competitive standing of the company. The existence of stakeholder councils to advise [sic] directors and investors on the health of the company would in turn provide a strong incentive for executives to nurture constructive relationships with stakeholders to find win-win solutions to problems.... [T]he use of stakeholder councils to advice[sic], or vet, nominees [to the Board] has the advantage*

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<sup>10</sup> However models of voting-based mechanisms for non-member stakeholders are available to entities that wish to pursue them (see point 3.18 below where Dr. Turnbull has suggested that this 'constructive involvement' with stakeholders may require dedicated forums).

*that it can be used with corporate entities which have one vote per member or one vote per share. It can also be embedded in the corporate charter or by-laws<sup>11</sup>.*

- 3.19. The flexibility required to design and implement these forums already exists in the capacity of entities to design Constitutions that fit their own needs<sup>12</sup>.
- 3.20. Such a variation, if adopted, would require entity managements to take a number of steps (itemised at 3.16 above). The last step, building on an identification of stakeholders and a quantification of the accountability owed to each, involves inscribing in the entity's governing documents or elsewhere the measures management will take to hold themselves accountable in the identified ways.
- 3.21. Some accountabilities will be relatively minor and measures to meet such obligations will be correspondingly light. Others will require more formal consultation of the kind envisaged by Dr. Turnbull. This may require quantifying and assigning the relevant responsibilities to different bodies within the organisation's corporate structure. The creation of such forums will always be subject to the restriction that one body would have to retain ultimate responsibility for the purposes of the *Corporations Act*.
- 3.22. However it should be possible, for example, to create advisory bodies for different categories of stakeholders, where appropriate; empower them to make recommendations for corporate action within a defined brief; and require the managing board to respond to these recommendations either by accepting and acting on them or by accounting fully for the reasons for inaction. Something analogous to this 'if not, why not' approach underwrites the Australian Stock Exchange Corporate Governance Council's application of the *Corporate Governance Principles and Recommendations*.
- 3.23. Such an arrangement goes a long way towards meeting what is, in my experience, the more common interest of members in community-based, membership-based charitable and NFP entities. Members are generally more interested in determining *what* the entity will do rather than the manner in which it does it (the back-end management responsibilities of compliance, risk and governance).

#### **4. Is the wording of Draft Standard Two appropriate?**

##### **4.1. If the reasoning and exposition of the preceding points is accepted, the best solution appears to involve (i) a change in the wording of Standard's Two and Four to shift the**

<sup>11</sup> p. 8, *ibid*

<sup>12</sup> In his submission to the Parliamentary Joint Committee's 2007 inquiry into shareholder engagement, Dr. Shann Turnbull also noted [p. 12, accessed at [http://www.aph.gov.au/Parliamentary\\_Business/Committees/Senate\\_Committees?url=corporations\\_ctte/completed\\_inquiries/2008-10/sharehold/submissions/sub23.pdf](http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=corporations_ctte/completed_inquiries/2008-10/sharehold/submissions/sub23.pdf)]

*A corporate Constitution is like the elephant in the living room that nobody notices. Every company has one but they are not seen. They are commonly accepted as a being given [sic] not a variable that needs to be designed to support and further the mission of the organisation... While political scientists research and teach how to construct constitutions for countries there is a global knowledge gap on how to design constitutions of firms or other types of organisations so as to sustain and further their operations*

**emphasis in accountability from ‘members’ to ‘stakeholders’ and (ii) the addition of a Note to the amended Standards, emphasising the capacity of registered entities to use the flexibility contained in their governing documents to design new accountability mechanisms that suit their specific and particular accountability requirements.**

4.2. The effect of this would be as follows:

<p><b>Draft Governance Standard 2: Accountability</b></p> <p><b>45.10 Standard 2 – Accountability</b></p> <p>Object</p> <p>1) The object of this governance standard is to ensure the accountability and transparency of a registered entity to its members and other stakeholders (which might include but are not limited to beneficiaries, funders, donors and staff/volunteers).</p> <p>Standard</p> <p>2) A registered entity must take reasonable steps to ensure that:</p> <ol style="list-style-type: none"> <li>a. The registered entity is held accountable in appropriate ways to all its significant stakeholders, including members if the registered entity is membership-based; and</li> <li>b. The registered entity’s stakeholders have adequate opportunities to raise concerns about the governance of the registered entity.</li> </ol> <p><i>Note 1</i> The steps that a registered entity may take to ensure it is accountable to its stakeholders include (but are not limited to) holding annual general meetings...</p> <p><i>Note 2</i> Entities are encouraged to explore accountability mechanisms (consistent with the obligations imposed by their form of registration and obligations to the ATO) that offer more meaningful forms of accountability to non-member stakeholders. These forms may involve variations to the entity’s Constitution and other governing documents. Such variations will require the registered entity to identify significant stakeholders to whom accountability is owed by the entity; the nature of the claims of each stakeholder on the entity; and the structural governance adjustments that meet the needs and entitlements of significant stakeholders.</p>
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## **5. Does Draft Standard Three establish appropriate principles?**

- 5.1. The principle established by the Standard is that charities and NFP’s must comply with the law.
- 5.2. The Consultation paper does not adequately canvass the reasoning behind the need for this principle. Why do charities require this reminder of what is a basic duty of citizenship for all individuals and corporations: to obey the law. The explanation of why the parameters are set where they are, is also not well made.

## **6. Is the wording of Draft Standard Three appropriate?**

- 6.1. Yes - if it is accepted that an articulation of the principle is required in this context.

## **7. Does Draft Standard Four establish appropriate principles?**

- 7.1. The objective of this standard is the promotion of transparency and accountability. As such, it addresses accountabilities which are covered in Standard Two and the objectives of both may be met by merging the two standards.
- 7.2. Sound financial management is a key interest of all stakeholders, not just members. The transparency and accountability-promoting objectives of this standard might be met by itemising financial management as one of the matters for which the directors will be held accountable to stakeholders for in Standard Two.
- 7.3. This might require the re-wording of Standard Two to include a representative (but not exclusive) sample of significant matters which accountability is required on.

## **8. Is the wording of Draft Standard Four appropriate?**

- 8.1. See 7.3 above

## **9. Does Draft Standard Five establish appropriate principles?**

- 9.1. Draft Standard Five considers the suitability of directors for management roles.
- 9.2. The emphasis in this Standard frames suitability entirely in the negative. As such it represents the most limited and limiting form of risk management approach to the matter of director suitability.
- 9.3. There is no equivalent itemisation of the positive attributes a director needs to possess in terms of qualifications, skills, or objective benchmarks of achievement establishing capacity to make an effective contribution to the governance task.
- 9.4. This is surprising because the governance task involves a variety of reasonably well defined responsibilities which are quantified and described in standard 'Position Descriptions' for directors' and committee members' roles.
- 9.5. The result of charities and NFP's operating on the basis of this oversight is equivalent to an entity recruiting for a paid position for which a well-designed position description exists but accepting the first person who presents for the job, without any reference to whether they can meet the selection criteria which would demonstrate capacity to undertake the work.
- 9.6. This outcome reflects the reality of current recruitment practice in many small, community-based charities and NFP's, which is usually highly informal. Many small entities approach the director recruitment task almost as an afterthought and with the primary focus being on the maintenance of a quorum. Moreover management committee

membership is often framed as a volunteer task, of essentially the same character as assisting with a homework help program, performing reception duties or flipping steaks at a fundraising sausage sizzle. This means that potential directors are often recruited to the management committee in advance of the AGM with a request to 'volunteer for the Committee'. The extent of the commitment required and responsibilities involved are often framed in the following terms: 'The Committee meets once a month on a Tuesday night for two hours and you don't have to do anything else except be there'.

- 9.7. One strategy to address the risks this Standard seeks to treat involves re-framing the recruitment function in positive terms: by identifying the principal accountabilities of directors and committee members (for policy, mission, strategy, risk and compliance etc.) and encouraging entities to recruit for people who possess the capabilities required (or who can develop them quickly).
- 9.8. A second strategy builds on the stakeholder forums model already identified. It involves encouraging registered entities to consider ways in which their governance arrangements (as framed in their governing documents) can be re-designed to clarify between the operational management responsibilities of their boards/committees (which tend to involve organisational management decision-making based on competencies and skills) and the service planning and direction responsibilities which, in my experience, are of most interest to community members. It is these service planning and direction activities which involve consulting with community members about the issues confronting their community and drawing them out on what the organisation's service priorities going forward should be.
- 9.9. This second strategy would also address a concern about the threat to small, community-based entities which have traditionally recruited Management Committee members from their own membership and which see having community members in governance roles of their own community organisations as one of the key deliverables of the community development approach they take to their work.
- 9.10. In my view, it is not protecting the capacity of small, community-based entities to establish and govern themselves effectively by having the Standards address only the legal unsuitability or otherwise of potential directors. The objectives of effective, representative and value-based governance would be better served by giving such entities clear direction about the expectations of the government and the community of the standards expected of the governance body

## **10. Is the wording of Draft Standard Five appropriate?**

- 10.1. One solution might be to make a note of the range of positive attributes a responsible entity will require to undertake the governance task in a charity or NFP.

- 10.2. Another might be to add a Note to Standard Five, similar in purpose and wording to the suggested Note for appending to Standard Two, and cited above at 4.2. To wit

*Entities are encouraged to explore accountability mechanisms (consistent with the obligations imposed by their form of registration and obligations to the ATO) that offer more meaningful forms of accountability to non-member stakeholders. These forms may involve variations to the entity's Constitution and other governing documents. Such variations will require the registered entity to identify significant stakeholders to whom accountability is owed by the entity; the nature of the claims of each stakeholder on the entity; and the structural governance adjustments that meet the needs and entitlements of significant stakeholders.*

**11. Are there concerns with allowing the ACNC to disqualify responsible entities and maintain a disqualified responsible entities register?**

- 11.1. The ACNC's powers in this regard are in line with the approach regulators have been taking for many years. If the ACNC's approach is subject to the same administrative law restraints as apply in other jurisdictions (e.g. elsewhere in company law), then it should not be a problem.

- 11.2. However, for the many charities I work with who are incorporated associations, this provision will be meaningless until application of the provision extends to entities which are not federally regulated.

**12. Does Draft Standard Six establish appropriate principles?**

- 12.1. To the extent that the Draft Standard harmonises the duties of and protections available to directors of charities with the duties and protections applying to other registered entities, the Draft is unexceptionable.

- 12.2. The principle concern is that the Draft Standard reads, at (2) that "*a registered entity must take reasonable steps to ensure that its responsible entities are subject to and comply with the following duties*". Responsibility for the registered entity's accountability for compliance on this matter belongs to the governance body. In other words, all directors will be held responsible collectively for the dereliction of duty by the individual director unless they can demonstrate having taken 'reasonable steps'.

**13. Is the wording of Draft Standard Six and the draft protections appropriate?**

- 13.1. There are only a couple of minor matters of clarification.

- 13.2. One relates to the Draft Protections at 45.100 where it reads "*if a responsible entity meets a protection mentioned in this subdivision...*" ...

- 13.3. In my view, a more appropriate wording might be *‘if a responsible entity meets one or more of the protections mentioned in this subdivision (with the protections to apply being determined on the regulator’s review of the facts of the particular situation in each case)...’*
- 13.4. The second matter is the Protection at 45.105 (2). Regard for the *‘responsible entity’s knowledge of the registered entity’* is an important element of determining whether or not the responsible entity has discharged the requirement for an *‘independent assessment of the information’* on which decisions are made or the exercise of duties based. However regard also needs to be had for the specific actions or steps taken by the responsible entity which give effect to (or constitute the activity of) independent assessment.
- 13.5. For this reason, I would suggest the wording be amended along the following lines to read *“in determining whether the responsible entity has made an independent assessment of the information or advice, regard must be had to (i) the responsible entity’s knowledge of the registered entity and the complexity of the structure and operations of the registered entity and (ii) the measures actually taken by the responsible entity to undertake that independent assessment.”* (my emphasis)
- 13.6. A third matter requiring clarification is the benchmark of materiality for material personal interests at 45.30 (2) (e). The CA does not define ‘material’ although the concept is extensively explored in case law and commentary. In my experience, the majority of problems with conflicts in small charitable institutions arise from a poor understanding on the part of directors of the corrosive effects on trust and legitimacy of perceptions of a conflict arising from personal relationships. It is only much more rarely that conflicts arise from directors’ opportunities to profit from the information of the entity or something similar which might give rise, in the minds of most directors of such small entities, to a conflict of interest they might consider ‘material’.
- 13.7. This being the case, it may assist these directors and others to clarify the threshold for materiality by reference in the accompanying guidance material to examples which will resonate with the responsible entities of small, community-based charities and NFP’s.
- 13.8. A similar reservation applies to the reference at Note 3 of the same section, to ‘related party transactions’ (RPT).

**14. Are there any additional protections which should only be provided to volunteer responsible entities?**

- 14.1. The prohibition on payments to directors for their services as directors which applies to most NFP’s mean that most responsible entities will be volunteers, irrespective of the size of the registered entities.

14.2. In my view, this is at the root of the difficulty entities of all sizes across the charitable and NFP sectors are having in recruiting able and qualified directors. The issue of payment of directors for their services *as* directors will have to be confronted sooner or later.

14.3. However the effect of additional provisions – ‘safe harbours’ or otherwise – would risk voiding any achievement of the preceding standards’ objectives. As such, my belief is that additional protections are uncalled for and likely to be counter-productive.

**15. If so, what would these protections be?**

15.1. See above.

**16. Are the transitional arrangements proposed adequate?**

16.1. The transitional arrangements as described are generous and no argument for extending them out further is presented.

**Additional general observations.**

17. The Consultation Paper (at 2.3.5) advises that entities will be responsible for assessing their own compliance with the standards and that the Commission’s default position will be ‘entities are compliant unless proved otherwise’.

18. The practical necessity of this measure is obvious. The Commission will never have the resources to actively scrutinise all the entities registered with it.

19. However without meaningful enforcement capacity – that is, an understanding by registered entities that there are real prospects of being detected in mistakes or wrong-doing and of enforcement actions being taken as a result – this effectively concedes defeat before the Commission’s oversight work is begun. Evidence of failure to comply is most likely to emerge by accident or only after disaster strikes.

20. By not mandating some Standards (or some elements of the Standards), the Commission’s approach risks the same credibility issues that plague the previous regulators of the sector – the Australian Securities and Investments Commission and state-based Offices of Fair Trading.

Thank you for your consideration of this submission. I look forward to the Review’s recommendations in due course.

Yours sincerely

**John Carrigan**