

Submission by

The Australian Institute of Company Directors

to

Federal Treasury

in response to the

Consultation Paper on “Review of not-for-profit governance arrangements”

27 January 2012

Introduction

This submission includes comments by the Australian Institute of Company Directors (Company Directors) in response to the Consultation Paper entitled “Review of not-for-profit governance arrangements”, released on 8 December 2011 (the Consultation Paper). Through providing our views we hope to assist Treasury and the Federal Government with their deliberations.

About Company Directors

Company Directors is the second largest member-based director association worldwide, with over 30,000 individual members from a wide range of corporations: publicly-listed companies, private companies, not-for-profit organizations (NFPs), charities, and government and semi-government bodies. As the principal professional body representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current director issues in policy debates.

The NFP sector has been a particular area of focus for Company Directors. Our activities have included tailored educational services, events, published materials, research, and facilitation of dialogue among members and others on NFP issues. We have participated in NFP policy reform discussions and lodged various submissions, for which we have had input from our membership, including our Policy Committees and NFP Steering Committee.

Company Directors has a significant interest in the national NFP reforms currently being progressed. Our Director Social Impact 2011 suggests that over half of our members currently hold at least one NFP directorship, in addition to other members who are or have been directly involved in the governance of one or more NFP entities.¹

More time is required for stakeholders to consider the questions contained in the Consultation Paper

While Company Directors has been a strong supporter of the Federal Government’s vision for an efficient, transparent, productive and vibrant NFP Sector, we must begin by expressing our extreme disappointment regarding the continued practice of Federal Treasury and the Federal Government to engage in consultations over the Christmas and New Years’ period, notwithstanding past pleas from Company Directors and others for this practice to stop. We do not regard relatively short consultations over this period as representing genuine attempts at seeking feedback.

The approach to the current review, along with a number of others currently underway by Federal Treasury and others, represents very poor regulatory

¹ Company Directors, *Directors Social Impact Study 2011*, at page 5.

review practice and must cease. Our concerns have been set out in letters to Federal Government Treasury Ministers.²

We acknowledge that subsequent to our letters, a one week extension of time was given in order for interested parties to make submissions in respect of this consultation. While this extension was welcomed, there has still been insufficient time for us to provide comprehensive responses to the questions raised, and there are parts of the Consultation Paper that we did not have time to consider at all.

In addition, for an area of such importance, we are disappointed at the very “thin” discussion around some key consultation questions (such as the role of the ACNC in providing guidance on governance issues). The Consultation Paper reads much more like an early “issues paper” than a “proposals paper”. More detailed consultation is required on many of the questions raised, as well as a more holistic approach to a variety of issues that are being discussed in the various NFP consultations that have recently taken place, are currently underway³ and are foreshadowed to occur in the near future.

While NFP reforms should not be unduly delayed, equally these reforms should not be progressed without proper and thoughtful consideration of the relevant issues. Based on current NFP consultations, we believe it would be preferable to extend the current 1 July deadline for the establishment of the ACNC and associated reforms, until after full and proper consultation has taken place and moves to reduce red tape are more advanced.

This submission should be read in conjunction with our responses to:

- the Consultation Paper titled “Scoping study for a national not-for-profit regulator”, released on 21 January 2011;
- the Consultation Paper “A Definition of Charity”, released on 28 October 2011; and
- the Draft Charities and Not-for-profits Commission Bill 2012, released on 9 December 2011.

General Comments

Our overall comments regarding the matters discussed and the questions raised in the Consultation Paper include:

- we consider the requirements in the Corporations Act 2001 (C’t) relating to companies limited by guarantee (with some amendments noted below) provide a good model for directors duties and governance requirements and should be adopted for charities and other NFPs;

² These letters are available at <http://www.companydirectors.com.au/Director-Resource-Centre/Policy-on-director-issues/Policy-Submissions/2011/Letters-to-Government-Ministers-on-Consultation-Issue>.

³ For example, the non-financial reporting obligations being considered as part of the Australian Charities and Not-for-profits Commission: Implementation design, Discussion Paper, 9 December 2011.

- notwithstanding the Consultation Paper is intended to lay the foundations for good NFP governance, we believe there is insufficient recognition of the role of good governance in driving an entity's performance⁴;
- we believe the current and related NFP consultations underestimate the governance standards which are applied in practice⁵;
- there is already a considerable amount of industry guidance available on good governance practices, and this should be given an opportunity to develop further before consideration is given to black letter law approaches;
- the Consultation Paper, while outlining the desire to promote governance, accountability and transparency of the NFP sector (paragraph 1), does not adequately recognise the high level of regulation and oversight that currently exists across the sector (for example in areas such as disability, health and aged care), and is largely silent on the existing benefits of such regulation and its well entrenched ties to existing structures;
- the Consultation Paper fails to identify where reductions in "red tape" are likely to occur; and
- to the extent that governance requirements that are over and above what is required by the Corporations Act are being contemplated, these should be disclosure-based and on an "if not, why not" basis.

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

Yes, responsible individuals (directors) should be required to act in the best interests of the relevant NFP entity.

Question 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 note that the Consultation Paper appears to be setting up the case or argument that, while commercial organisations have shareholders to keep the board/management accountable, NFPs may not, and therefore there needs to be accountability (and therefore duties owed) to a broader class of relevant stakeholders.⁶ Company Directors does not agree with this position.

In Australia, it has been a longstanding principle of corporate law that directors have a duty to act in the best interests of the company. We do not see why this longstanding concept should apply differently to NFPs. Duties owed by "responsible individuals/directors" should only be owed to the entity itself; not

⁴ See, for example, the emphasis on the protective aspects of good governance at paragraphs 26 and 32 of the Consultation Paper.

⁵ For some insights into NFP governance refer to the Australian Institute of Company Directors, *Directors Social Impact Study 2011*. Available at - <http://www.companydirectors.com.au/~media/754828C5958C45C58A482009E2D1DFC2.ashx>.

⁶ See, for example, Consultation Paper at paragraphs 40 and 90.

to the broader class(es) of stakeholders. If duties are owed by the responsible individuals to a range of stakeholders, conflicts between the interests of stakeholders will inevitably arise, and complicate and encumber decision-making, or possibly make it practically impossible to make decisions.

In practice, determining what is in the best interests of the company/entity will require directors or responsible individuals to assess the interests of a range of stakeholders including members, donors, creditors, employees and the broader community. In considering what is in the best interests of the entity, the responsible individual's focus on a particular stakeholder group may be greater or less depending on the decision to be made and the circumstances of the entity at the time.

By ensuring responsible individuals owe duties to the entity, the law may then provide that the responsible entity has obligations to others. The exercise of the responsible individual's duties in the best interests of the entity, will therefore require them to take the entity's obligations into account.

Allowing directors or responsible individuals to serve only one master, the entity, ensures that responsible individuals are able to make decisions that weigh up the interests of a range of stakeholders but which ultimately work for the entity as a whole. Any change to this fundamental principle of corporate law in the NFP sector would be a retrograde step.

We would add:

- The Corporations Act duties are deemed appropriate for officers who manage organisations which receive public monies (listed companies) and on occasion receive Government funding (public and private companies).
- The Commonwealth Authorities and Companies Act 1997 (CAC Act) governance provisions regulate officers of Commonwealth Authorities and Commonwealth Companies who deal specifically with public monies. The CAC Act adopts the Corporations Act duties for officers.
- The Corporations Act duties have, through a well-developed body of jurisprudence, been shown to have the flexibility to allow courts to recognise the differing levels of experience and knowledge of individual officers and the individual requirements and obligations of the particular organisation they manage.
- The Corporations Act duties already apply to a significant number of existing NFP organisations (i.e. all NFP companies limited by guarantee).
- If incorporated associations are to continue to be used for smaller NFPs, the State and Territory Association Acts can be amended to import the relevant provisions of the Corporations Act, in the same way as Associations Acts currently import the Corporations Act provisions for winding up procedures for Associations.

- Creating a new and different set of duties for NFP officers will create confusion, possible unnecessary litigation and will discourage persons from accepting NFP board appointments, which in turn will be detrimental to the sector.

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

Duties should be similar to those contained in the Corporations Act. Refer to our responses to Questions 10 and 2.

Question 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?

Duties should be similar to those contained in the Corporations Act. Refer to our responses to Questions 10 and 2. In addition, special regard should be had for volunteers in the context of a Corporations Act, section 1318 style provision where a person has acted honestly and reasonably and in all the circumstances should be excused from liability (but not to lower the original benchmark requirements which would result in an overall lowering of standards).

Question 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)?

No. We note:

- the issue of whether an individual possesses the requisite experience and/or qualifications is likely to vary from case to case, and over time;
- in some cases the benefit of qualifications or “experience” may be illusory, while in other cases, mandated minimum standards may serve as an unreasonable constraint;
- we contend this may potentially create a “chicken or the egg” issue (how do you get relevant experience if you do not meet the minimum experience criteria?); and
- many NFP directors serve on a pro-bono basis, and even without mandated minimum experience/qualification constraints, NFPs often find it difficult to attract suitable directors.

If the concern is that directors may lack appropriate experience and/or qualifications, we believe the issue is far better dealt with through a combination of disclosure, industry guidelines and by encouraging NFP directors to seek continual training and professional development.

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

No. We believe this will introduce distortions and have unintended adverse consequences. See our response to Question 5.

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

Once the Federal Government has developed a tentative position on duties for NFP directors (we would suggest modelling these on the director duties contained in the Corporations Act – see below), there should be further consultation on this issue.

Question 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 proposed NFP framework should enhance, not detract, from the ability of NFP organisations to secure and retain high calibre directors on their governing bodies. We note there are many instances of directors serving on boards of NFPs on a pro bono basis and this can and often does represent a valuable resource for the organisations concerned.

The Director Social Impact Study 2011 found, based on survey responses⁷, that:

- approximately 89% of non-executive NFP directors are performing their role on a voluntary basis, with only 11% receiving director fees; and
- NEDs of NFPs spend on average almost seven working weeks annually on their directorship duties.⁸

Where individual directors serve on both for-profit and NFP boards, the inherent flow of cross-sector governance experience and expertise at board level is not to be underestimated. As we have previously stated, it would be most unfortunate if the development of governance practices in for-profit and NFP sectors occurred in “silos”.

Question 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 do not consider this appropriate given the wording of the director duties in the Corporations Act.

⁷ The Director Social Impact Study 2011 was based on survey responses from 1912 members of Company Directors, with 58% of respondent s holding current NFP directorships.

⁸ The Australian Institute of Company Directors, *Directors Social Impact Study 2011*.

Question 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?

For the sake of certainty and to avoid differing parallel streams of responsibility for commercial corporations and NFP entities, the responsibilities and duties which apply to the NFP sector should be essentially the same as under the Corporations Act, subject to the following qualifiers. We believe:

- there should be extended “business judgement rule” protection (perhaps better termed a “mission judgement rule”);
- there should be a slightly “softer” insolvency regime recognising that future funding certainty of charitable/NFP operations is often more tenuous than for for-profit businesses; and
- special regard should be had for volunteers in the context of a Corporations Act section 1318, style provision where a person has acted honestly and reasonably and in all the circumstances should be excused from liability (but not to lower the original benchmark requirements which would result in an over-all lowering of standards).

We would be extremely concerned if the outcome of this consultation was to end up with a quasi-codified regime which is separate to and more onerous than what exists under the Corporations Act.

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

We believe, as a matter of general principle, that charities should not be required to disclose any more corporate governance information than is required of companies limited by guarantee under the Corporations Act. We accept, however, there is some merit in having such information presented in a way that aids comparisons as part of the proposed ACNC information portal. We will be providing our comments in response to the Discussion Paper titled “Australian Charities and Not-for-profits Commission: Implementation design” (released on 9 December 2011) in due course.

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

We believe that, in circumstances where a NFP is required to prepare a directors report or equivalent, the disclosure of aggregate remuneration of responsible individuals (i.e. not individualised remuneration) is sufficient.

We would be concerned if detailed remuneration disclosure requirements were to be introduced. We make the following observations.

- There is no evidence of any systemic abuse.

- Many NFP directors serve on a pro-bono or nominal fee basis.
- This would represent an unnecessary compliance burden for the vast majority of NFPs.
- Remuneration disclosures are adequately addressed in the Australian accounting standards.
- The disclosure of individual remuneration of key management personnel of listed companies led to a ratcheting up of remuneration levels⁹.

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

We believe that the current requirements in the Corporations Act relating to material personal interests are appropriate for NFPs. Any further detail, such as the contents of a conflict of interest policy, should remain the subject of industry guidance.

Question 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)?

See our response to question 13.

Question 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’?

Conflict of interest requirements should be based on those relating to material personal interests in the Corporations Act.

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

We do not believe any additional risk management requirements are necessary or desirable:

- we consider it would be a strange and unreasonable outcome for NFPs to be subject to risk management or other corporate governance requirements that listed companies (which obtain funds from the public) are not;
- these are unnecessary if there is an appropriate set of director duties in place;
- why is it that risk management requirements are being singled out from the host of other possible requirements relating to governance practices?; and

⁹ Refer to the submission by Company Directors to the Productivity Commission’s Issues Paper titled “Regulation of Director and Executive Remuneration in Australia”, 29 May 2009.

- an opportunity should be provided for further industry guidance to be developed on such issues before moving to a black letter law approach.

In addition we note that there is no “one size fits all”, or for that matter no “one size fits most”, for risk management or other corporate governance issues.

Question 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. See our response to Question 16.

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

No. See our response to Question 16.

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

No. This should remain a decision of responsible individuals. Should individuals be forced to have indemnity insurance, this will restrict the pool of NFP directors, at a time when many NFPs have difficulties in attracting appropriately qualified and experienced individuals to serve of their board (mostly on a pro-bono basis – see above).

Question 20. What internal review procedures should be mandated?

None. See our response to Question 16.

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

The core minimum requirements should not extend further than what currently apply to companies limited by guarantee under the Corporations Act. To the extent that further requirements are under consideration, these should be disclosure-based and ideally as part of ACNC’s proposed information portal.

Question 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. While we take the position that there should be no mandated governance requirements over and above what are currently imposed on companies limited by guarantee by the Corporations Act (i.e., additional governance arrangements should be left to each NFP to determine), where governance requirements are mandated we believe that this is more appropriately the role of Parliament than the ACNC.

We consider that the ACNC could serve a useful role through acting as a “gateway” to the industry guidance that currently exists on NFP governance issues, both domestically and overseas.

Question 23. Who should be able to enforce the rules?

This depends on the type of organisation. In the case of a membership-based organisation, it should be a requisite number of members who are able to enforce a NFP’s governing rules.

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

More detail is required for this question to be properly considered. Our initial response is that the ACNC should not have such a role.

Question 25. Should model rules be used?

We support the current approach in the Corporations Act as it relates to companies limited by guarantee.

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

We support the current approach in the Corporations Act as it relates to companies limited by guarantee.

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

More detail is required for this question to be properly considered. Our initial response is, no.

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

No. We consider that in many cases this would present an unreasonable burden on such entities, for little benefit. This should remain a matter for the NFP and its members to decide.

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

We consider that the ACNC could provide basic guidance on legal requirements, and act as a gateway to industry guidance on good governance practice.

Question 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?

To the extent that governance requirements are being contemplated over and above what is required by the Corporations Act, these should be disclosure-based and on an “if not, why not” basis. There should also be a minimum size threshold, that is the subject of further consultation (e.g. the NFP is of a size that requires it to prepare a directors’ report).

We refer to our earlier remarks relating to red tape reduction under the heading of General Comments.

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

An option missing here is industry guidance. We believe that industry guidance should be the starting point. Such guidance should be encouraged and given time to develop further.

We note the huge success and acclaim that the ASX Corporate Governance Council has had both in Australia and overseas.

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

We do not consider a case has been made for Indigenous NFP entities to be subjected to any additional governance requirements, over which apply to other NFPs.

Question 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?

Please refer to our opening comments.

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