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Manager
Philanthropy and Exemptions Unit
Personal and Retirement Income Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: NFPreform@treasury.gov.au

Dear Madam/Sir

Consultation Paper Review of Not-for-Profit Governance Arrangements

Thank you for the opportunity to comment on the Consultation Paper of the Review of Not-for-Profit Governance Arrangements (Consultation Paper).

CPA Australia is one of the world's largest professional accounting bodies, with a membership of more than 139,000 finance, accounting and business professionals and leaders in 114 countries. Our vision is for CPA Australia to be the global professional accountancy designation for strategic business leaders. We make this submission on behalf of our members and in the broader public interest.

CPA Australia's involvement and interest in the charities and not-for-profit sector stems from our public interest remit and the significant role our membership plays in this sector. Our members provide valuable services (both paid and pro-bono) to the charities and not-for-profits sector both as public practitioners and through direct involvement in the governance and management of charitable and not-for-profit entities.

General Comments

CPA Australia supports the Government's efforts to strengthen and streamline the governance arrangements of the NFP sector and the Australian Charities and Not-for-Profits Commission's (ACNC) objectives of promoting good governance, accountability and transparency. However, the consultation period for the review of NFP governance arrangements and the Australian Charities and Not-for-profits Commission Bill, provided us with inadequate time to enable the contributions of our Members and other interested parties. This is especially important given the impact the proposals will have on them and the sector in general.

CPA Australia suggests that the proposed timeframes for the establishment of the ACNC, the development and application of the proposed governance arrangements and the

legislation should be reconsidered. The Consultation Paper mentions that 'the outcome of this review will feed into the legislation establishing the ACNC, and any legislation relating to issues of governance requirements for NFPs will be in place in time for the commencement of the ACNC on 1 July 2012'. The Exposure Draft of the Australian Charities and Not-for-profits Commission Bill has been released and comments are required by 27 January 2012, the same date as those of the NFP Governance Arrangements Consultation Paper. Given the proposed timeframes an open consultation on the governance requirements is not possible. This, we believe, is a major issue that affects the credibility and value of the process, as well as the adoption of the outcomes. We consider it important that the sector is able to fully participate in the development of the governance principles and requirements and express its views on them, as they will govern its cultural and structural systems, policies and processes.

If the review of the NFP governance arrangements is going to inform the legislation then a time frame that enables that process needs to be established with adequate opportunity for consultation. Given the far reaching and systemic changes that may be required for many entities in the sector the proposed timeframe limits not only the effectiveness of the developmental and consultative process but also the opportunity for information dissemination, awareness raising and education. Charities will be required to comply with the reporting requirements from 1 July 2012 and would therefore need to ensure that they have appropriate systems and processes in place before that date. Given that the requirements have not been formulated it is unclear how this can be feasible.

The success of the negotiations with States and Territories is fundamental to the accomplishment of the stated ACNC objectives, namely to simplify requirements and improve governance and transparency. This is another reason to review the proposed time frames as more time would allow the negotiations to take place and thus a clear sector management framework to be developed with certainty.

The proposed framework recommends a principles-based approach to governance. CPA Australia supports the adoption of a principles-based approach to NFP governance as we believe that such an approach is adaptable, efficient and would apply in all circumstances without the need for onerous specific prescriptions. It also enables the creation of a governance mindset that is based on the interest of the entity and its stakeholders instead of promotion of a compliance or 'tick-box' approach to governance. We suggest that the starting point for the governance framework be the establishment of governance principles through adequate consultation with the sector and its stakeholders. We believe the approach adopted by the Charity Commission for England and Wales, where the regulatory framework supports the governance principles, is more appropriate than the inclusion of the governance principles in the regulatory framework. As a consequence, we would encourage the ACNC to oversee the development of the governance principles in the sector and support them with the regulatory and compliance framework.

The development of the governance framework is an important undertaking for ACNC. It is not clear if a governance code is to be developed and, if so, what its status will be. Clarity will also be required in the relationship between the code and the existing and proposed legislation and any guidance that may be developed. As a first step we suggest that those responsible for the governance of NFP entities be identified and the principles that will enable good governance be developed. It is unclear whether the requirement that all NFP entities have a governing body responsible for governance will be imposed. CPA Australia believes that a fundamental aspect of governance is the clarification of who has ultimate responsibility for it. The Consultation Paper discusses responsible individuals and their duties but does not clarify whether responsible individuals are responsible for governance and therefore risk management and overall accountability.

CPA Australia proposes that the governance and regulatory frameworks that are being developed for the NFP sector should be aligned with existing frameworks to the degree

possible. This alignment should include the fundamental principles, language and systems. Such an alignment will enable those charged with governance of NFP entities who may also be involved in governance of for-profit entities to be informed of and comply with requirements. It will also communicate that despite the differences between the sectors, the objectives of governance are paramount in all sectors. Further requirements for NFP sectors can be added but we do not see the development of an independent framework with a different terminology and emphasis conducive to the governance improvements in the sector. To achieve this, the ASX Corporate Governance Principles and Recommendations or the public sector governance framework can be used as the basis and adapted to reflect the specific stakeholder interests of the NFP sector.

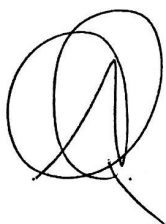
If the NFP governance arrangements are going to be principles-based then CPA Australia believes that the development of the principles is the first task to be undertaken. Overall the Consultation Paper addresses a number of important elements that are to be considered but, despite repeated mentions of high level principles, it does not provide the high level principles that it will be founded upon. We see a consultation with the sector on the development of the principles as necessary and following the completion of this process the legislation and implementation of the governance arrangements can be addressed. We suggest that the starting point for the review of not-for-profit governance arrangements be the establishment of the governance principles.

It may be appropriate to distinguish between the governance principles and minimum standards that the ACNC will regulate and with which NFP entities will be compelled to comply. The application of the governance requirements initially to charities raises the question as to what obligations would other NFP entities have in the short and medium terms and how these obligations would be imposed.

Where principles or provisions are adapted from corporate law there is a need to recognise that corporate law is in some respects a relatively cohesive set of rules. Under corporate law persons dealing with a company are recognised as able to assume particular matters in relation to the appointment, powers and responsibilities of directors. If the ACNC Bill adapts some rules in relation to these matters the coherence that exists in corporate law may be absent. We therefore consider important that the overarching considerations that exist in corporate law are applied to the proposed NFP scheme.

Our responses to the consultation questions are in the Comments on Consultation Questions section that follows. If you have any questions regarding this submission please do not hesitate to contact Dr Eva Tsahuridu, CPA Australia by email at Eva.Tsahuridu@cpaaustralia.com.au.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Alex Malley', written in a cursive style.

Alex Malley FCPA
Chief Executive Officer

Comments on Consultation Questions

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

The duties of the responsible individuals focus on the duties of such individuals towards the entity but not on their duties on behalf of the entity. The development of the board's duties in ensuring good governance need to be developed in line with the governance principles. We believe that the clarification of who has ultimate responsibility for the governance of the NFP entity must be made clear as such individuals would assume the responsibility for control, performance, strategy and risk management.

We consider it appropriate that the legislation requires responsible individuals to consider the interests of the entity and its stakeholders and not define specific classes of stakeholders.

In addition, inclusion of a provision similar to Corporations Act 2001 s 140 that gives contractual effect to the corporate constitution, specifying in particular between whom the contractual effect applies, should be considered.

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?*

CPA Australia believes it is necessary that each entity identifies its primary stakeholders and ensures it provides value to them, considers their interests and where appropriate communicates and informs them. We do not think it is possible, nor appropriate, for the legislation to identify specific stakeholders. NFP entities need to identify and consider their stakeholders.

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

CPA Australia is of the opinion that the duties of the responsible individuals of NFP entities must be similar to those imposed by the Corporations Act 2001 to directors or officers of corporations, as expressed in paragraph 91 of the Consultation Paper.

- a duty of care and diligence;
- a duty to act in good faith in the best interests of the entity;
- a duty to not misuse their position;
- a duty to not misuse information; and
- a duty to disclose material personal interests.

In addition we are of the opinion that responsible individuals must act with integrity, care and diligence.

CPA Australia also considers important the inclusion of a provision similar to s 185 of the Corporations Act 2001. This provision establishes that the general duties in ss180 to 184 have "effect in addition to, and not in derogation of, any rules of law relating to the duty". The effect of this provision is to preserve the applicability of common law rules which have built up over many decades of corporate law development. If there are similar general law rules about the conduct of NFPs consideration should be given to the preservation of their effect.

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?*

CPA Australia believes that the reasonable third person test, used in the Corporations Act 2001 and CATSI Act 2006, provides an adequate standard of care required of responsible individuals to fulfil their duties.

Paid employees and volunteers should have the same standard of care because, despite their remuneration, they are agents of the entity acting on its behalf to fulfil its objectives. The beneficiaries of the NFP entity and its other stakeholders have the right to expect appropriate standard of care regardless of the status of the entity's agent. Professionals may have additional standards of care imposed on them by their profession.

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)?*

The variety of competencies, experiences and skills required will vary between NFP entities and as such we do not advocate the setting of prerequisite qualifications, experiences or skills. We do support the clear communication of the requirements of each role with a job description and person specification and the development of processes to ensure that appointments of responsible individuals fulfil the requirements, as well as the establishment of appropriate induction, ongoing professional development opportunities and performance review.

We note that in corporate legislation a prescriptive statement of requisite director skills has been avoided. Instead "holding out" has been used as a measure of the suitability of persons occupying these positions. This might be adapted to the NFP context.

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

All responsible individuals should have the required competencies to fulfil the requirements of their roles.

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

The standardisation of the general duties as described in question 3, as they are principles-based, are applicable to all responsible individuals in all entities and as such there are no identified issues with their adoption.

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?*

In line with the high level principles-based approach we support the provision of governance principles that would apply proportionately to all NFP entities. Ascertaining the appropriate standard of care would be a responsibility of the individuals responsible for governance. The third party test can be used to ensure the appropriateness of the standard of care adopted.

Further, the principle of the reasonable foreseeability of harm which is the basis of the civil law duty of care can cater for the different types of NFPs.

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 duties in the Corporations Act and CATSI Act are similar and should be adopted.

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

In line with other governance arrangements, we believe that once the governance principles are developed, communicated and adequate support provided to all NFPs, they should be able to disclose to the ACNC whether there are any aspects of the governance framework that the entity did not apply. We suggest that the “comply/apply or explain” approach is an effective means of motivating entities to consider the governance principles developed and the duties that arise from them.

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

CPA Australia supports the disclosure of the aggregate remuneration of key management personnel in line with Accounting Standard AASB 124 *Related Party Disclosures* to enable transparency and accountability.

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

CPA Australia is of the opinion that any requirements in relation to conflicts of interest should be aligned with those imposed by the Corporations Act. Specific conflict of interest policies should be developed by NFPs as part of their governance infrastructure.

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)?*

CPA Australia supports the provision of conflict of interest principles that apply to all NFPs. We do not advocate the development of different conflict of interest requirements imposed on different types of entities.

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’?*

The stipulation of types of conflict is not desirable as it could inadvertently be used as a checklist and preclude the consideration of all potential conflicts. It is also not possible to construct an all inclusive list of all potential types of conflicts in all types of entities. CPA Australia believes that emphasis must be placed on the active consideration by NFPs of any relationship or circumstance that impairs objectivity and processes developed to identify and address such circumstances in line with a principles-based approach.

We support the adoption of the existing Corporations Act concept of ‘material personal interest’.

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

CPA Australia believes that each NFP entity should be encouraged to develop a risk management framework that will enable it to identify and manage risk through broad

governance principles not legislation. We see risk management as a fundamental element of governance and would thus expect the individuals responsible for the governance of the entity also responsible for risk management.

Funding organisations currently oversee the management of risk of funding recipients and we do not support the imposition of any further regulatory requirements.

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

CPA Australia does not support the imposition of any specific requirements but, in line with a principles-based approach, encourages the development of specific and appropriate requirements that are developed at the entity level. We see these as matters of internal management and thus the responsibility of those charged with the NFP entity's governance. If there are specific requirements for certain NFPs such requirements should be included in the governing rules or constitution of the entity.

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

While insurance could be beneficial it would be hard to mandate possible unforeseen circumstances precisely because they are unforeseen. The only possibility would be to mandate comprehensive levels of insurance that would cover a range of unforeseen circumstances but the cost of such insurance may be prohibitive for many NFP entities.

NFP entities should consider the issue of insurance as part of their risk management framework but we do not think they should be compelled to have certain levels of insurance except those imposed by legislation. This approach is in line with that of the UK Charities Commission which proposes that 'insurance cover should only be taken out if the level of risk which is to be passed to the insurer makes the insurance premium worth spending (unless it is required by law)'.

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

CPA Australia is of the opinion that the need for indemnity insurance should be assessed as part of the risk management framework by each NFP entity, like other insurance, but not be imposed.

20. *What internal review procedures should be mandated?*

CPA Australia supports the development of a robust system of internal and external review procedures to guarantee credibility of information and improve transparency. CPA Australia's publications *Internal Controls for Not-For-Profit Organisations* (<http://www.cpaaustralia.com.au/cps/rde/xbcr/cpa-site/internal-controls-for-nfp-organisations-brochure.pdf>) and *Financial Management of Not-For-Profit Organisations* (http://www.cpaaustralia.com.au/cps/rde/xbcr/cpa-site/financial_management_of_not-for-profits.pdf) offer a range of procedures that help NFP entities identify, develop, implement and review necessary internal controls.

As described in *Internal Controls for Not-For-Profit Organisations* we propose that NFP entities develop control procedures that address:

- human resources – including hiring policies, conflict of interest, job descriptions, training, performance evaluations, remuneration and disciplinary procedures

- administration and financial – including job responsibilities, segregation of duties, procedures for key administration activities, reporting relationships, financial authorities and access to assets
- reporting – including frequency, content, preparation responsibility, identification of stakeholders
- systems – including access security, system hardware and software purchase and maintenance, procedures for key activities such as purchasing and disbursement of funds, disaster recovery and emergency planning.

We believe that the board of the NFP entity and its management should have the ultimate responsibility for internal control but specific internal controls should not be mandated.

Given the different characteristics of entities in the NFP sector we do not think the prescription of specific internal review procedures is possible through legislation.

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

In line with the current provisions of the Corporations Act 2001, CPA Australia is of the opinion that the Australian Charities and Not-for-Profits Commission Bill should contain governing rules (replaceable rules) that apply to all entities. Entities should also have the option to develop their own rules in their own constitution or use a combination of the two alternatives.

We see a constitution or other document that sets out the mission, core objectives, powers, activities and structure of NFP entities as necessary. For many existing charities (such as companies limited by guarantee), other legislation or regulations impose a requirement to have in place a formal document that sets out the entity's constitution. However, where there is no such legislation or regulations, it would be necessary for the regulator and the regulatory framework to impose this requirement, along with rules and guidelines on the required content.

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?*

ACNC should mandate requirements in the governing rules it develops as we suggested in the previous question. The board or those charged with governance should have the responsibility of ensuring the entity abides by the rules.

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

The ACNC with any other relevant regulators should be able to enforce the governing rules but we believe there is a need to clarify the status of the ACNC in relation to other regulators.

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

Entities should be required to inform ACNC in the event of alteration of the governing rules. Additional rules similar to the corporate law member remedy rules (Part 2F.1) can be used to enforce the constitution and regulate the conduct of the entity.

25. *Should model rules be used?*

Model or replaceable rules can be used but entities should be given the option to develop their own rules if they so prefer as long as their own rules address the necessary areas of coverage.

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

CPA Australia believes that any rules that are developed, should reflect the Corporations Act's provisions, should be replaceable and set minimum requirements.

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

No.

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

Membership based entities should have the requirement of an annual general meeting included in their governing rules.

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

ACNC's role in the education and provision of support to the sector is an important one and the production of guidance and support important. Consultation and participation are also important to improve awareness in the sector and improve its motivation to improve governance. As described in our general comments, we believe the process of establishing the framework is as important as the outcome and affects its success.

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?*

The reduction in red tape will be achieved if ACNC together with relevant State and Commonwealth agencies and regulators agree on the governance requirements, as well as on the role ACNC will play in their implementation. In the absence of such agreement ACNC is likely to increase the regulatory burden on the sector, something that will affect its effectiveness.

It is not clear how and whether the current proposals will achieve the objective of introducing the one stop shop since the necessary agreements with relevant parties and regulatory alignment have not been accomplished.

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

As mentioned in our earlier comments we are of the opinion the development of the appropriate principles through consultation with the sector should be developed initially. We do not think the establishing of the governance arrangements prior to the establishment of the principles is the most effective way of undertaking the review because the principles are expected to guide the appropriate systems and processes that need to be developed and will clarify the what obligations are owed and by whom. Following this current consultation it is not clear what the proposed governance arrangements are and how the sector will be required to change to ensure that it satisfies them. Given the proposed timeframe we think this is an issue of crucial importance.

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

CPA Australia does not consider different governance requirements for Indigenous NFP entities desirable. The governance principles-based requirements should be applicable to all NFP entities.

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.