

Review of not-for-profit governance arrangements

Consultation Paper
December 2011

© Commonwealth of Australia 2011

ISBN 978-0-642-74766-2

This publication is available for your use under a Creative Commons Attribution 3.0 Australia licence, with the exception of the Commonwealth Coat of Arms, the Treasury logo, photographs, images, signatures and where otherwise stated. The full licence terms are available from <http://creativecommons.org/licenses/by/3.0/au/legalcode>.



Use of Treasury material under a Creative Commons Attribution 3.0 Australia licence requires you to attribute the work (but not in any way that suggests that the Treasury endorses you or your use of the work).

Treasury material used 'as supplied'

Provided you have not modified or transformed Treasury material in any way including, for example, by changing the Treasury text; calculating percentage changes; graphing or charting data; or deriving new statistics from published Treasury statistics — then Treasury prefers the following attribution:

Source: The Australian Government the Treasury

Derivative material

If you have modified or transformed Treasury material, or derived new material from those of the Treasury in any way, then Treasury prefers the following attribution:

Based on The Australian Government the Treasury data

Use of the Coat of Arms

The terms under which the Coat of Arms can be used are set out on the It's an Honour website (see www.itsanhonour.gov.au)

Other Uses

Inquiries regarding this licence and any other use of this document are welcome at:

Manager
Communications
The Treasury
Langton Crescent Parkes ACT 2600
Email: medialiaison@treasury.gov.au

CONSULTATION PROCESS

REQUEST FOR FEEDBACK AND COMMENTS

The Government is seeking your input to the governance arrangements for not-for-profit entities.

While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please email responses in a Word or RTF format. An additional PDF version may also be submitted.

All submissions received will be treated as public documents unless the author of the submission clearly indicates the contrary by marking all or part of the submission as 'confidential' prior to the submission being lodged. Public submissions may be published in full on the Treasury website, including any personal information of authors and/or other third parties contained in the submission. If your submission contains the personal information of any third party individuals, please indicate on the cover of your submission if they have not consented to the publication of their information.

A request made under the *Freedom of Information Act 1982* for access to a submission marked confidential will be determined in accordance with that Act.

Closing date for submissions: 20 January 2012

Email: NFPreform@treasury.gov.au

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

Enquiries: Enquiries can be initially directed to Chris Leggett or Tamara Hartwich

Phone: 02 6263 3357 or 02 6263 2514

CONTENTS

- CONSULTATION PROCESS III**
 - Request for feedback and comments iii
- FOREWORD..... VII**
- INTRODUCTION VIII**
- 1. CONTEXT1**
- 2. WHAT IS GOVERNANCE?.....5**
- 3. WHY IS GOVERNANCE IMPORTANT?7**
- 4. PRESSURES FACED BY THE NFP SECTOR9**
- 5. EXISTING ARRANGEMENTS11**
 - 5.1 Companies limited by guarantee11
 - 5.2 Corporations under the Corporations (Aboriginal and Torres Strait Islander) Act 2006 (CATSI Act)11
 - 5.3 Incorporated associations11
 - 5.4 Charitable trusts12
 - 5.5 Unincorporated associations12
 - 5.6 Joint ventures12
 - 5.7 Co-operatives13
 - 5.8 Other Structures13
- 6. DISCUSSION15**
 - 6.1 Responsible individuals’ duties15
 - 6.2 Disclosure requirements and managing conflicts of interest19
 - 6.3 Risk management23
 - 6.4 Minimum requirements for an entity’s governing rules26
 - 6.5 Relationships with members28
- 7. SUMMARY31**
- APPENDIX I: INTERNATIONAL COMPARISONS33**
 - 7.1 England and Wales33
 - 7.2 New Zealand37
 - 7.3 United States39
 - 7.4 Canada41

FOREWORD



I am very pleased to release this consultation paper on the current governance arrangements applying to not-for-profit (NFP) entities.

In the 2011-12 Budget, the Minister for Social Inclusion and I announced a package of NFP reforms, including the establishment of the Australian Charities and Not-for-profits Commission which will make it easier for the NFP sector to deliver their services for the public benefit.

One of the announced measures was that Treasury would conduct a review of current governance arrangements faced by the NFP sector.

The *Final Report of the Scoping Study for a National Not-for-profit Regulator* highlighted the concerns of the NFP sector about duplicative, burdensome and unclear governance requirements across all Australian jurisdictions. The report also made several recommendations concerning governance arrangements applying to the sector.

Governance affects many aspects of a NFP's operations. While most NFPs have effective governance policies in place, some do not. This paper will help determine what the core organisational governance principles applying to registered NFPs should be. By streamlining and centralising governance arrangements into one framework, and reducing red tape, NFPs will be able to spend less time complying with duplicative or burdensome arrangements, and more time helping the community.

Because charities make a very important contribution to Australian society, they receive a range of support from Commonwealth, state, territory and local governments, including tax concessions and grants, and support from the public in terms of donations and volunteering. As NFPs are in receipt of this generous support, there is placed upon them high community expectations, thereby making transparency and accountability very important objectives.

This paper is the first stage in Treasury's review, and provides an opportunity for the NFP sector and the wider public to engage on this important issue.

The Hon Bill Shorten MP

Assistant Treasurer and Minister for Financial Services and Superannuation

INTRODUCTION

In the 2011-12 Budget, the Government announced that it would establish the Australian Charities and Not-for-profits Commission (ACNC) and that Treasury would undertake a review into the governance obligations appropriate for registered not-for-profits (NFPs) (regardless of entity type), taking account of the findings of the *Final Report of the Scoping Study for a National Not-for-profit Regulator* (Final Report).

This paper focuses on the governance arrangements for NFPs. Governance refers to the practices and procedures in place to ensure that an entity operates in such a way that it achieves its objectives in an effective and transparent manner. NFPs are, by definition, not seeking a profit from their operations for the benefit of their members; they exist instead to provide benefits to the community by way of a public mission or purpose. This means they are run very differently from commercial entities or government entities. However, NFPs must operate within the law.

The Final Report highlighted the concerns of the NFP sector about duplicative, burdensome and unclear governance requirements that are imposed and apply in many forms across the Commonwealth and the states and territories. The Final Report found that a principles-based approach to governance would be largely welcomed by the sector, particularly for smaller NFPs who often lack the resources to develop detailed and prescriptive governance policies which would be largely unnecessary for many smaller entities.

This paper seeks views from the sector and other stakeholders about which arrangements work best and what should be the core governance arrangements for NFPs.

It is envisaged that there will be some high-level principles-based mandatory requirements for registered entities, as well as some good practice guidance. There may be a number of instruments used, for example, primary and delegated legislation, but it is intended that all the organisation governance requirements for NFP entities will be centralised through the ACNC.

The development of principles-based core rules for governance requirements for NFP entities is consistent with the vision of the *National Compact: Working Together* as it will assist in promoting a strong and sustainable NFP sector, through increased transparency and accountability. This will help to underpin and sustain a strong philanthropic engagement by the community and support for the vital work that the NFP sector undertakes, often on behalf of government.

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.

Most NFP entities will already have adequate governance procedures in place, and therefore we do not expect that they will have to make any substantive changes to existing arrangements as a result of centralising the governance arrangements.

1. CONTEXT

1. The Government is committed to strengthening the not-for-profit (NFP) sector and announced the first stage of an ambitious reform agenda in the 2011-12 Budget, including the establishment of an independent statutory office, the Australian Charities and Not-for-profits Commission (ACNC). The ACNC will work to improve public trust and confidence in the sector, through promoting governance, accountability and transparency of the NFP sector.
2. These reforms follow a long history of inquiries in this area. There have been a number of reviews which have recommended wide-ranging reforms to improve arrangements for the NFP sector.
3. The current governance arrangements for NFPs in Australia are complex, ad hoc, and can lack transparency. Existing arrangements can also be duplicative, often resulting in high and unnecessary compliance costs.
4. The intent of the governance review is to centralise and simplify the existing arrangements in order to reduce red tape and minimise compliance burdens for the sector.
5. It is envisaged that there will be some high-level principles-based mandatory requirements for registered entities, as well as some good practice guidance. There may be a number of instruments used, for example, primary and delegated legislation, but it is intended that all the organisation governance requirements for NFP entities will be centralised through the ACNC.
6. Core governance principles will provide flexibility so that any requirements are proportional. What a large NFP must implement to satisfy the requirements will be different from what a small NFP must do to satisfy the requirements.
7. While most entities have effective and thorough governance policies in place, the arrangements for other entities do not meet community expectations in relation to entities in receipt of public monies and support. Recent trends have seen higher levels of governance and accountability required of both the commercial and government sectors in Australia. However, the NFP sector has, until now, been largely ignored.
8. As part of its 2010 election commitment to strengthen the NFP sector, the Government committed to a Scoping Study for a national 'one-stop shop' regulator.
9. The consultation paper on the Scoping Study, released in January 2011, included questions regarding governance, disclosure and compliance of NFPs.
10. It was clear from the consultation responses that there are diverse approaches to governance within the NFP sector.
11. The *Final Report on the Scoping Study for a National Not-for-Profit Regulator* (Final Report) concerning the establishment of a new NFP sector regulator concluded that the diversity of the sector should drive consideration of suitable governance arrangements. While submissions to the report were generally supportive of improved governance arrangements, respondents were cautious of an overly prescriptive approach. The Final Report found that a

principles-based approach to governance would be largely welcomed by the sector, particularly for smaller NFPs who often lack the resources to develop detailed and prescriptive governance policies which would be largely unnecessary for many smaller entities.

12. The Final Report also found that governance rules should take into account the size of the entity, the risks it presents by virtue of its activities, and turnover as well as the level of government support a NFP receives.
13. The Final Report provided several recommendations concerning the governance of the NFP sector. These were:
 - 13.1. entities that are currently regulated by ASIC should be incorporated within the regulatory framework as soon as new reporting and governance frameworks are implemented. ASIC should still retain responsibility for incorporation;
 - 13.2. acquittal reporting should be outcomes based and should not include financial reporting or reporting related to organisational governance;
 - 13.3. organisational governance rules should be proportional to the size of entities, risk factors and receipt of public and government assistance;
 - 13.4. the regulation of service provision should remain with existing entities;
 - 13.5. government contracts should no longer mandate organisational governance requirements for NFPs; and
 - 13.6. over the long term, the national regulator should be provided with powers regarding asset protection, the suspension and/or removal of responsible persons, registration and deregistration, the enforcement of governance rules, investigative processes, enforcement powers, including civil penalties and the imposition of fines, proportional compliance activities, and, dispute resolution processes.
14. Additionally the Final Report recommended that Treasury should undertake a review to determine what, if any, should be the core organisational governance principles applying to registered NFPs.
15. The Government announced in the 2011-12 Budget a number of further reviews of aspects of the regulation of the NFP sector, including a review of the governance obligations appropriate for NFP entities. This paper is the first stage in Treasury's review, and provides an opportunity for the NFP sector and the wider public to engage on this important issue.
16. This paper is seeking views on whether some of the existing governance arrangements in place for the NFP sector, for example, those imposed on companies limited by guarantee, are appropriate for the entire NFP sector.
17. Some NFP entities are currently under structures administered by federal legislation, such as companies limited by guarantee, while the power to regulate other structures generally resides with the states and territories, such as incorporated associations and charitable trusts.

18. 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.
19. Most NFP entities will already have adequate governance procedures in place, and therefore we do not expect them to make any substantive changes to existing arrangements.
20. We are not expecting those entities that have to change existing governance procedures to change them overnight. Should entities be required to make changes as a result of the standardisation, appropriate transitional arrangements will be in place where it is necessary for an entity to make changes. This will allow for a smooth transition to the ACNC.
21. It is envisaged that any governance requirements under Commonwealth powers, such as those in the *Corporations Act 2001* ('the Corporations Act'), will be replaced with new uniform governance requirements, and not be in addition to existing governance requirements. This means that the ACNC will take over governance arrangements of NFP companies limited by guarantee from ASIC.
22. The Government hopes to work with the states and territories to ensure that the ACNC will be a national regulator, and be responsible for monitoring and administering all governance requirements of registered entities, regardless of structure.
23. While the aim is not to impose additional requirements on top of any existing governance requirements, it should be acknowledged that the process of negotiation with the states and territories in aligning requirements may take time. Some duplication during a transitional period might result while Australia moves towards a truly national NFP regulator, however, the governance arrangements are likely to be similar, and not pose a large burden on NFPs.
24. The ACNC will have a role in assisting NFPs to achieve best practice governance outcomes by producing guidance material which demonstrates what best practice governance is, and explaining how NFPs can adopt such practices easily into their day-to-day operations.

2. WHAT IS GOVERNANCE?

25. Governance is concerned with the practices and procedures put in place to ensure that an entity is run in such a way that it achieves its objectives in an effective and transparent manner. For NFPs, governance is focussed on how they deliver their mission in the most appropriate way, with due regard for legal requirements, accountability, stakeholder expectations and even ethical considerations.¹
26. Corporate governance can be defined as ‘a system of checks and balances between management and other interested parties’. It is a way for organisations to define themselves to all stakeholders in terms of compliance and accountability.² It can also be viewed as the way in which an entity is steered or stewarded, and therefore relates to the functions and procedures of governing. Corporate governance can refer to the way in which trustees or directors provide oversight for companies and other entities, and to what objectives.
27. Sir Adrian Cadbury states that: ‘*Corporate governance is an area that is concerned with the balance between the economic and social interests of goals and between individual and communal goals ... the aim is to align as nearly as possible the interests of individuals, corporations and society*’.³
28. To promote sector confidence and support a strong NFP sector, registered entities must have good governance, internal financial and management controls in place.
29. Individuals with levels of responsibility in a NFP entity have a duty to act according to high ethical standards and not to misappropriate funds. The responsible individuals will vary in accordance with the chosen structure of the entity; in relation to a company, the responsible individuals would include the board of directors, whereas in an incorporated association, a committee may manage the association.
30. Governance issues include:
 - 30.1. setting the duties and minimum standards of responsible individuals, including rules for proper organisational management and running of the entity;
 - 30.2. disclosure requirements and managing conflicts of interest;
 - 30.3. risk management of the entity, including such things as insurance requirements, whether there are any investment rules and requirements and internal/external independent reviews;
 - 30.4. minimum requirements for an entity’s governing rules; and
 - 30.5. relationships with members (including dispute resolution mechanisms).

1 Chartered Secretaries Australia, http://www.csaust.com/AM/Template.cfm?Section=Reports_from_Other_Jurisdictions&Template=/CM/ContentDisplay.cfm&ContentID=3114.

2 Biegelman & Bartow, 2006: 44.

3 World Bank Report, 1999.

3. WHY IS GOVERNANCE IMPORTANT?

31. Governance provisions help align the interests of the management with the mission and purpose of the entity, and thereby with the interest of donors, beneficiaries, and the public at large.
32. The object of governance rules is to ensure compliance, transparency and accountability of NFP entities to their volunteers, donors, beneficiaries, the public at large, and members (where applicable). Further, the rules should create a framework to protect the entity and its mission or purpose from mismanagement, and ensure that the entity is focussed on its mission, and not the goals or interests of others.
33. NFPs play a unique role in Australia, and as a result are funded by governments, both directly and indirectly, and by donations from members of the public. This unique role means that governments often afford them special treatment by way of grants, tax concessions and exemptions from a range of laws and fees.
34. NFP entities generally operate for the broad public benefit, and are relied on by many Australians, often by those individuals who are the most vulnerable in our community.
35. It is for these reasons that NFP entities must have appropriate governance requirements in place. Best practice should also be encouraged.
36. Currently, the governance requirements, if any, of a NFP entity depend on its structure — such as whether it is an unincorporated entity, a trust or a company limited by guarantee, whether the entity has a peak body — such as the Australian Council for International Development (ACFID) to implement a code of conduct, or the sector the NFP operates in — such as the health and education sectors. Governance requirements may also currently be included in contracts that government enters into with the sector.
37. The scoping study recommended that any principles that are developed should apply across all NFP entities falling under the jurisdiction of the ACNC, regardless of their structure or sector.
 - 37.1. It is factors such as the size of the entity, turnover, the risks it presents by virtue of its activities and the level of government support that an entity receives that should determine the level of governance — not the vehicle or entity type that has been chosen to advance the purpose.
38. In addition, many of the governance requirements that currently apply to some NFP entities, which come about through the choice of entity structure, apply to both for-profit and NFP entities, and have not been developed specifically for NFP entities.
39. Many of the existing governance requirements are based on the relationship between directors and shareholders or members, where those parties have the ability to voice their concerns and keep management in line.
40. Focussing solely on this relationship may not be effective in a NFP entity where (in many cases) there are no shareholders, but there are a range of other interested parties who need their

interests protected as they may not be able to do so themselves. NFPs must be accountable to these interested parties, such as volunteers, donors, beneficiaries and the public at large.

- 40.1. These groups do not have the same direct relationship with the NFP as a shareholder has with a for-profit entity.
 - 40.2. The 'beneficiaries' of the NFP usually do not have any legal interest in the operation of the entity and sometimes do not have a voice to protect their interests because they are not people (for example, animal welfare charities or environmental charities).
 - 40.3. Donors gift money to an entity with the understanding that it will be used for a particular purpose, but do not have any legal rights if the entity is not operating to pursue its mission/purpose.
 - 40.4. Public funding and the public purpose of NFPs mean that these entities must have a level of accountability to government, as representative of the public as a whole.
41. Appropriate governance arrangements are required to ensure that the NFP entity is operating in the best interests of those affected by its operations, and to further its stated goals, and not for the interests of management.
 42. Because of the diversity of both the sector, and those it is responsible towards, developing strong governance arrangements will help to underpin public confidence in the sector, through improved transparency and accountability. The diversity of the sector should drive consideration of suitable principles-based governance arrangements that embody flexibility, proportionality and public confidence.
 43. This review is looking to reduce red tape, and not impose additional requirements on NFP entities and will therefore remove duplicative governance requirements, such as ASIC requirements for companies limited by guarantee.
 44. Moving to a single scheme would necessitate core governance rules to be developed. Any core governance rules developed would be compulsory for entities seeking registration by the ACNC. From 1 July 2012, this will include all charities registered by the ACNC. Appropriate arrangements will be put in place to allow a smooth transition for existing entities.
 45. The ACNC will be responsible for administering the legislation, and will not have a legislative function itself. As such, it is important to have these governance rules in place for the commencement of the ACNC.
 46. The ACNC will have a role in assisting NFPs to achieve best practice governance outcomes by producing guidance material which demonstrates what best practice governance is and explaining how NFPs can adopt such practices easily into their day-to-day operations.

4. PRESSURES FACED BY THE NFP SECTOR

47. Many of the pressures and challenges that are raised in the governance of for-profit entities are similar to those for the NFP sector. Responsible individuals in both for-profit and NFPs are charged with overseeing the entity and ensuring its financial health, and they are subject to the same high standards of conduct and both have a range of financial, legal and ethical duties to fulfil.
48. However, some pressures are more pronounced for NFP entities. At the base level this includes the consideration of time and money. As many responsible individuals voluntarily provide their service, they are often trying to squeeze their service in among the demands placed on them by paid employment.
49. Many responsible individuals may also be board members of for-profit entities, and should fully understand the duties placed on them.
 - 49.1. However, while they may understand the relationship a for-profit has to its shareholders, they may not fully understand the implications of a NFP entity being in receipt of public monies, and accountable to the public, as well as being accountable to groups which may not have a voice.
50. Other pressures NFPs face in implementing and managing internal governance stem from NFP entities' mission-based, rather than profit-based, focus. NFPs generally often operate with very scarce financial and human resources, presenting unique challenges as they seek to develop methods for raising funds and keeping their entity in good financial shape.
51. Because of the mission-based focus of NFPs, there may not be the same level of external oversight that shareholders place on managers who are entrusted with their monies, as members do not have the same financial stake, and beneficiaries and the general public do not have the same direct relationship with the NFP as a shareholder has with a for-profit entity.
52. However, NFP entities must still ensure that the public monies received are being spent according to the purpose they were provided for (and not subject to mission drift), and that they are operating in accordance with the law at all times.
53. NFPs often face issues simply in making decisions. While larger entities may have managers in place, for many smaller ones, decisions will often have to wait until the next Board or membership meeting, making it difficult to progress issues, and respond to changes in environment.
54. There are also unique challenges in terms of workforce issues. While the use of volunteer labour can be a bonus for some entities, and a necessity for others, it also comes with its challenges. Volunteers have to be recruited, trained and monitored, and they often have to be insured and/or screened, adding to the compliance and governance burden.
55. Further, the changing relationships between the NFP sector, government and the public in Australia have thrown a light on the perennial issues of accountability and efficiency. The

increased involvement of the NFP sector in service delivery for government means that there is greater emphasis on these issues, and requirements on their governance structures and processes, as well as greater pressures on NFP entities to deliver with limited resources.

56. There are risks of corruption in the NFP sector as in any sector. However, as the NFP sector holds the trust of the community, serving and protecting the most vulnerable in society, this can create unique risks and challenges. The high use of volunteers and the lack of resources available to check on their credentials and supervise their activities are also a risk factor.
 - 56.1. If a large case of fraud were to eventuate, there would be significant implications for both the entity and the NFP sector, as the nature of NFP entities mean that resources can deplete quickly when individuals lose faith in an entity, or the sector. This could cause both volunteers to stop engaging, as well as donations to fall for not just the entity affected, but the NFP sector as a whole.
57. At the most serious end of the scale, individuals may seek to use NFP entities to launder money or finance terrorism. A combination of special exemptions from a range of laws, including low reporting requirements and ease of sending money overseas provides an opportunity for such individuals to take advantage of a NFP for their own benefit.
58. Another example of corrupt conduct may be the false acquittal of a government grant, or its expenditure on purposes it was not intended for. A similar example may be the spending of donor funds on private purposes.
59. There are a number of awards offered by various groups to encourage good governance practices in the NFP sector, including the PwC Transparency awards and the Givewell Best Practice awards. These awards help encourage best practice organisational and financial management, transparency and accountability within the sector, and award entities displaying such procedures.
60. However, further work needs to be done in this area.
61. A balance needs to be struck between rules to deter malfeasance with a culture which promotes compliance, self-regulation and transparency, and the compliance burden placed on NFP entities.

5. EXISTING ARRANGEMENTS

62. What governance arrangements are currently applicable to NFPs depends on the structure of the NFP, whether the entity has a peak body and the sector the NFP operates in.
63. The common structures for NFP entities are summarised below.

5.1 COMPANIES LIMITED BY GUARANTEE

64. Currently, there are approximately 11,000 NFP entities that are constituted as companies limited by guarantee. These entities are regulated by Australian Securities and Investments Commission (ASIC), and the Corporations Act.
65. Both ASIC and the Corporations Act stipulate certain governance requirements for those entities structured as companies limited by guarantee, and NFP entities generally have to comply with similar governance requirements and disclosure obligations as for-profit corporations, including the statutory directors' duties and rules facilitating member participation.

5.2 CORPORATIONS UNDER THE CORPORATIONS (ABORIGINAL AND TORRES STRAIT ISLANDER) ACT 2006 (CATSI Act)

66. Indigenous corporations registered under the CATSI Act are currently regulated by the Office of the Registrar for Indigenous Corporations (ORIC).
67. ORIC currently regulates approximately 2,600 Indigenous corporations, approximately 80 per cent of which are NFP entities. The activities of ORIC include advising entities on how to incorporate, providing corporate governance training, mediating disputes, making sure corporations comply with the law and intervening when needed.

5.3 INCORPORATED ASSOCIATIONS

68. The power to incorporate and regulate incorporated associations resides with the states and territories, and each jurisdiction has enacted distinct legislation to deal with this field. While the legislation itself is broadly similar in each state and territory, governance requirements and arrangements differ across jurisdictions.
69. Associations incorporated under state and territory associations incorporation legislation are not administered by ASIC, but by the various state and territory registrars. An incorporated association is also a legal entity separate from its individual members and can hold property, sue and be sued. Incorporating an association in a state or territory restricts the entity to operating in its home jurisdiction. For example, an association incorporated under the

Associations Incorporation Act 2009 of New South Wales may only carry on 'business' in New South Wales.

5.4 CHARITABLE TRUSTS

70. Charitable trusts are also regulated at the state and territory level, and trustees of the trust have fiduciary duties which are set out in both statute and the common law, which has developed over a significant period of time.
71. A charitable trust is a form of express trust established to manage and distribute funds to individuals and entities for a charitable purpose and for the benefit of an appreciable section of the public.
72. Private ancillary funds are a form of ancillary trust fund designed to encourage private philanthropy by providing private groups, such as businesses, families and individuals, with greater flexibility to start their own trust funds for philanthropic purposes.

5.5 UNINCORPORATED ASSOCIATIONS

73. Some community groups are known as unincorporated NFP associations. An unincorporated association is essentially no more than a collection of people who have come together to work for a particular cause or aim that does not involve making a profit for members. The association will usually have a name and rules but the group itself does not have a separate legal identity distinct from its members. This has the potential to cause problems for the group because it restricts the activities it can undertake and allows committee members (and sometimes even general members) to be sued for the debts of the group and the negligence of its members.
74. Unincorporated associations have no regular reporting or governance requirements except in relation to tax obligations. There are few means for government to encourage good governance practices or give entities the chance to demonstrate their engagement in such practices.

5.6 JOINT VENTURES

75. In some circumstances a community group may undertake a joint venture (sometimes referred to as a 'partnership' in the community sector). Joint ventures exist where two legal entities combine for a particular, commercially-based project. The temporary nature of this arrangement makes it distinct from a merger (where two community groups join forces permanently to become one). It is unusual for community groups to embark on joint ventures because their main purpose is profit-making. However, community groups sometimes do so for fundraising purposes, service delivery or advocacy.
76. The term 'joint venture' differentiates the arrangement from a partnership because these arrangements are different in a number of ways, for example, joint venture participants are not subject to the duty of mutual trust or confidence as between partners. It is important to note, however, that parties to a joint venture may be 'jointly and severably liable' — that is,

liability attaches to both parties as a group, and as individuals. This means that a creditor may obtain payment from either of the parties, or both.

5.7 CO-OPERATIVES

77. Like an incorporated association, a co-operative is a body with legal status. It is controlled by members and run for the common interest of the group. Co-operative societies are suitable only for some purposes, and most community groups do not fit the profile. Co-operatives can be NFP entities, however they usually come together for business purposes. This means that the involved parties often have an interest in the operations of the co-operative, providing an additional level of oversight.

5.8 OTHER STRUCTURES

78. Some entities, such as churches and religious entities, are incorporated by special statutes or Royal Charter, or are branches of international entities, and in some cases fall outside of the current regulatory system. Incorporation by special statutes or Royal Charter is in most cases a historical arrangement and are often not applicable to newly forming entities.

6. DISCUSSION

79. To ensure that NFP entities receiving public support (in whatever form) operate under appropriate and sound leadership, appropriate governance requirements need to be in place, and best practice needs to be encouraged. This will help align the interests of the management with the interests of donors, beneficiaries, and the public at large and focus management on the mission/purpose of the entity.
80. To make it easier for the NFP sector, core governance principles-based rules that apply to all registered entities could be applied across the sector, with the level of regulation proportional to the size of the entity, its turnover, the risks it presents by virtue of its activities and the level of government support that an entity receives.
81. Any core governance rules developed would be compulsory for entities seeking registration by the ACNC. From 1 July 2012, this will include all charities registered by the ACNC.
82. The ACNC will administer the national regulatory system, which will remove or reduce the need for governance requirements to be imposed by other instruments such as government contracts, as risks associated with poor governance will be managed at an organisational level by the national regulator.
83. Governance principles have been grouped into the following areas:
 - 83.1. duties and minimum standards of responsible individuals, including rules for proper organisational management and running of the entity;
 - 83.2. disclosure requirements and managing conflicts of interest;
 - 83.3. risk management procedures;
 - 83.3.1. internal and external reviews and auditing requirements;
 - 83.4. the coverage of the minimum requirements of governing rules; and
 - 83.5. relationships with members.

6.1 RESPONSIBLE INDIVIDUALS' DUTIES

84. Responsible individuals of registered entities must have regard to fulfilling the duties required of a responsible individual.
85. For these purposes, who is a responsible individual will be based on a definition to be included in the ACNC legislation, which is expected to include:
 - a director or officer of the registered entity;

- a trustee of the registered NFP entity, or a director or officer of a trustee of a registered entity;
 - an individual:
 - who makes, or participates in making, decisions that affect the whole or a substantial part, of the registered entity’s activities; or
 - who has the capacity to significantly affect the registered entity’s financial standing; or
 - who in accordance with whose instructions or wishes the responsible individuals of the registered entity are accustomed to act (excluding advice given by the individual in the proper performance of functions attaching to the individual’s professional capacity or their business relationship with the registered entity on its responsible individuals); and
 - a receiver and manager, administrator, liquidator or trustee in bankruptcy of an incapacitated NFP.
86. Where the responsible individual is a receiver and manager, administrator, liquidator or trustee in bankruptcy (of an incapacitated NFP), these duties will need to be considered in conjunction with their other duties (such as a duty to the creditors of the entity) which may take precedence.
87. NFP entities have responsibilities to donors, beneficiaries, volunteers, government, members (where applicable) and the public at large, and responsible individuals must act with care and diligence, in good faith, and not misuse their position. Responsible individuals must exercise at least the same degree of care, diligence and skill that a prudent individual would exercise in managing the affairs of others.
88. Part 2D.1 of the Corporations Act and Division 262 of the CATSI Act 2006 contain the directors’ duties that apply to companies limited by guarantee and indigenous corporations, such as various direct duties and annual general meeting requirements.
89. However, as these requirements are based on a director-shareholder/member relationship, they may not be sufficient for a NFP entity. The many groups that NFPs are accountable to often do not provide the same level of oversight, or have a legal interest in the entity.
- 89.1. Given the beneficiaries of a NFP entity do not have any legal interest in the operation of the entity, and additionally, may not be people (and hence not have a voice), this level of oversight is sometimes missing from NFP entities.
- 89.2. However, governance procedures to align the interests of members and managers are still important and necessary.
90. Appropriate duties of responsible individuals provide some level of oversight that an entity is operating in the best interests of those affected by its operations, such as beneficiaries and the public, and help to keep the entity operations focussed on its mission, and operating for its cause, and not the interests of the responsible individuals.

91. However, at a high level, many duties are still applicable to NFP entities, such as:
- 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.
92. It is the responsibility of the responsible individuals of the entity to ensure that they understand their role, are aware of their legal duties, and are ensuring that the NFP entity is operating to the highest standards. This also requires that the responsible individual must be honest and careful in their dealings at all times, and act in the entity's best interests.
93. Responsible individuals of incorporated associations have obligations that are broadly similar between the states and territories. Under general law, the office holders in incorporated associations are in a fiduciary relationship with members, and so they owe several fiduciary duties. These general law duties cover duties:
- to act in good faith in the best interests of the entity and for a proper purpose;
 - to act with reasonable care and skill (including the duty to prevent insolvent trading);
 - not to improperly use information or position; and
 - to disclose and manage conflicts of interest.
94. The trustees of charitable trusts have a fiduciary responsibility to exercise their powers with integrity and good faith and avoid any personal conflict of interest or real possibility of conflict of interest. Other duties include that they should be familiar with the terms of the will/deed, act gratuitously, and keep proper accounts.
95. In addition, all Australian states and territories have enacted legislation governing the broad duties and responsibilities of trustees. For example, in NSW, the *Trustee Act 1925* gives trustees both powers and duties. The powers are broad and state that the trustee can invest funds in any form of investment, or vary the investment at any point in time (section 14). In terms of duties, a trustee must, in exercising a power of investment, exercise the care, diligence and skill that a prudent person would exercise in managing the affairs of other persons. The section imposes a greater duty on trustees whose profession, business or employment is or includes acting as a trustee or investment money on behalf of other persons (section 15).
96. In relation to private ancillary funds (PAFs), trustees have an obligation to exercise appropriate care and skill in managing private ancillary funds. Guideline 13 for PAFs states: 'The trustee of the fund must exercise the same degree of care, diligence and skill that a prudent individual would exercise in managing the affairs of others.' Private ancillary funds are a sub-set of charitable trusts.

97. Each fund must have at least one director on the board of its trustee who is an individual with a degree of responsibility to the community as a whole (a responsible person). The responsible person must be a director of the trustee and a member of any other controlling body of the fund. This rule applies to deductible gift recipients more generally and is intended to ensure that an independent and publicly trustworthy and accountable individual is actively involved in the management and protection of these monies which have been donated for the benefit of the broader public and supported by significant philanthropic tax concessions.
98. There are often minimum standards or qualifications to be eligible to be a responsible individual. Further certain conduct may result in an individual being disqualified from remaining a responsible individual.
99. The Corporations Act requires an individual to be over 18 years of age to become a director. An individual must also not act as a director (or manage a company) without court consent if they:
- become bankrupt or are an undischarged bankrupt;
 - are subject to a personal insolvency agreement or an arrangement under Part X of the Bankruptcy Act that has not been fully complied with;
 - are subject to a composition under Part X of the *Bankruptcy Act 1966* and final payment has not been made; or
 - have been convicted of various offences such as fraud or offences under company law, such as a breach of duties as a director or insolvent trading.
 - Convicted individuals cannot manage a company for five years, and if imprisoned for one of these offences, they cannot manage a company within five years after release from gaol.
100. The PAF guidelines state that an individual must not be a director of a trustee or a member of any other controlling body of the fund if he or she has been convicted of a taxation offence that is punishable by imprisonment for a period exceeding 12 months (that is, an indictable offence).
101. Under trust law, a court could remove and replace a trustee of a charitable trust where that trustee has breached his or her fiduciary duties.
102. Under a principles-based approach, a responsible individual would need to act with, for example, care and diligence, however the standard of care and diligence expected of the particular individual would depend on the size of the entity, the amount of public monies the entity is the recipient of, the qualifications of the individual, the position they hold, or the risk of the entity's activities.
103. In England and Wales, the Charity Commission has established voluntary high-level principles-based governance requirements include that an effective board will provide good governance and leadership by exercising effective control, behaving with integrity and being open and accountable.

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?
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?
3. What should the duties of responsible individuals be, and what core duties should be outlined in the ACNC legislation?
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?
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)?
6. Should these minimum standards be only applied to a portion of the responsible individuals of a registered entity?
7. Are there any issues with standardising the duties required of responsible individuals across all entity structures and sectors registered with the ACNC?
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?
9. Are there higher risk NFP cases where a higher standard of care should be applied or where higher minimum standards should be applied?
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?

6.2 DISCLOSURE REQUIREMENTS AND MANAGING CONFLICTS OF INTEREST

104. The requirements for what information is currently required to be disclosed by a NFP entity differ across the various available legal structures. Requirements may spell out what information a NFP is required to disclose, and the types of conflicts of interest it is required to avoid.
105. Disclosure in governance refers to a whole array of different forms of information produced by an entity, such as the annual reports produced, fundraising income and expenditure, related party transactions, remuneration of responsible individuals and communications such as media releases and information placed on websites.

106. Improvements in disclosure generally result in improvements in transparency, which in itself safeguard against mismanagement. Given that NFPs are in receipt of public support, there is placed upon them high community expectations, thereby making transparency and accountability very important. In addition, NFPs rely heavily on their reputation in the community, and a lack of transparency may lead to a loss of donations and lower levels of volunteering.
107. Current disclosure requirements cover various types of information. Tiered/proportional reporting requirements are currently being introduced, and will be consulted on as part of the ACNC legislation. The ACNC will be introducing a general purpose reporting framework. The ACNC implementation taskforce is currently consulting on the reporting framework.
108. The PAF guidelines require that all transactions between the fund and a founder of the fund, a donor to the fund, the trustee, a director, officer, agent, member or employee of the trustee, or an associate of any of these entities must be disclosed in the financial statements.
109. The Australian Accounting Standards contain various disclosure requirements. The Australian Accounting Standards Board (AASB) provide a list of standards, which may apply to NFP entities depending on what activities they carry out. The list of standards can be found on their website: www.aasb.gov.au.
110. Accounting standards are essentially about disclosure and efficiency, with the aim of ensuring accountability and that all interested parties have the necessary information to make informed decisions.
111. Registered charities would be required to submit an information statement in an approved form to the ACNC, and that financial reports will be prepared in accordance with Australian Accounting Standards and lodged with the ACNC for mid-tiered and upper-tiered entities. In relation to disclosure, the relevant standards, depending on a NFP's activities, are likely to include: Financial Instruments: Disclosures (AASB 7); Disclosure of Interests in Other Entities (AASB 12); Employee Benefits (AASB 119); Related Party Disclosures (AASB 124); and Accounting for Government Grants and Disclosure of Government Assistance (AASB 120).
112. However, what information should be disclosed in addition to the required financial information needs to be considered, such as related party transactions or the remuneration of responsible individuals.
113. ASIC imposes disclosure requirements on companies seeking to raise funds. However, there are some circumstances where companies can fundraise without a disclosure document. The ASIC website contains a 'Road Map' to assist companies in determining the requirements imposed on them.
114. The states and territories also impose disclosure requirements on charities. For example, The SA Liquor and Gambling Commissioner administers the *Collections for Charitable Purposes Act 1939 (SA)* to protect the public interest in the area of fundraising by NFP groups by providing disclosure requirements for charitable collections (section 6 licence) and entertainment (section 7 licence). Charities and their Collection Agents are required by legislation to lodge annual 'Fundraising Income and Expenditure Statements' to provide the public with information regarding Charities and Collection Agents' financial performance in relation to charitable collections and entertainment. Licensees can also authorise the Minister to publish their audited accounts.

115. Similarly, in NSW and Victoria the legislation relating to charities requires charities to disclose their fundraising income and expenditure. *Givewell research*, however, has shown that the rate of adherence to that requirement (though better in NSW) is still quite variable in both states.⁴
116. In 2008, the Senate Standing Committee on Economics conducted a review into the 'Disclosure regimes for charities and not-for-profit organisations'. Recommendations included that: 'a tiered reporting system be established under the legislation for a specialist legal structure.'
117. The Report also cited a survey conducted by Choice which found that 81 per cent of respondents did not know what proportion of their charitable donation reached their favoured charity's beneficiaries, while 94 per cent considered it important to have access to that information. The survey also found wide variability and inconsistency in the way that charities communicate key information to donors. In some cases, such information was not publicly available at all, as some charities did not publish their annual reports or financial accounts.⁵
118. In regard to unincorporated associations, the report noted that establishing any formal disclosure regime may be seen to be onerous, and may provide a disincentive for the continuation of these (often) small entities. However, the Report expressed that this needs to be balanced with the community expectations that even small entities need to be accountable to government and the community in the event of fraud, mismanagement, or concerns for public safety.
119. The remuneration of management and board members can be a contentious issue for NFPs, particularly in attracting and retaining staff. However, given that NFP entities are often in receipt of public monies, and receive various concessions, such as tax concessions, consideration needs to be given to some level of disclosure. For example, ACFID's Code of Conduct requires, where applicable, for a documented policy in relation to any remuneration by the signatory organisation of members of the governing body. This policy must be approved at the annual general meeting of the members of the organisation.
120. NFP entities may also pay fees to member entities, for example, the Australian branch of an international entity may pay a membership fee, or an entity may send money to an overseas branch of the same operation. Allowing the public and other interested parties to know about such related party transactions improves the information they have about the entity, and allows them to make more informed decisions.

6.2.1 Conflict of interest

121. ASIC and the Corporations Act governance requirements for entities structured as companies limited by guarantee, require that NFP entities comply with the same governance requirements and disclosure obligations as for-profit corporations, including the statutory directors' duties and rules facilitating member participation. This includes the duty to disclose material personal interests.

121.1. The effect of declaring material personal interests is that the individual with certain material personal interests in a matter may not vote on the matter or attend directors'

⁴ http://www.givewell.com.au/faq_charities.asp (accessed on 17 November 2011).

⁵ Choice Magazine, Charities, March 2008, as cited in 2008 Senate Report.

meetings while the matter is being considered, unless approved by non-interested directors.

121.2. While 'material personal interest' is not defined in the Corporations Act, the word 'material' implies that the interest needs to be of some substance or value, rather than merely a slight interest. An interest that has the capacity to influence the vote of a director would be considered material.

122. ASIC also considers that while conflict of interest principles are relevant to the concept of material personal interest, it is possible for a matter that does not give rise to a conflict of interest to nonetheless be a material personal interest, in which event, the board must decide if the relevant director can be present and vote at the directors' meeting.

123. Similarly, for those NFP entities falling under the jurisdiction of the CATSI Act, there is a duty for directors to avoid conflicts of interest.

124. The fiduciary duties of office holders in incorporated associations require office holders to disclose and manage conflicts of interest as part of their fiduciary obligations to the entity.

125. Principle 5 of the England and Wales Charities Commission governance principles states that an effective Board will provide good governance and leadership by behaving with integrity, in part by identifying, understanding and managing conflicts of interest and loyalty.

126. The law could require all NFPs under its jurisdiction abide by a conflict of interest policy. A sample policy might include that:

- a responsible individual should avoid any conflict arising between their personal interests (or the interests of any other related person or body) and their duties to the entity;
- a responsible individual must not take advantage of their position to gain, directly or indirectly, a personal benefit, or an benefit for any associated entity (their wife, say, or a commercial entity);
- a responsible individual shall not make use of inside information (such as knowing the details of a tender application of a NFP and using this to undercut it);
- the personal interests of a responsible individual member, and those of associated individuals, must not be allowed to take precedence over those of the entity generally;
- a responsible individual should seek to avoid conflicts of interest wherever possible. Full and prior disclosure of any conflict, or potential conflict, or the appearance of potential conflict, must be made to the decision-making body. Once the conflict has been declared, responsible individuals must decide whether the responsible individual should:
 - refrain from voting (this is a minimum);
 - refrain from participating in the debate;
 - withdraw from the meeting during the debate and the voting;
 - suggest that the responsible individual consider resigning; and

- where possible, develop should develop guidelines on what kinds of appearance of conflict call for what level of care.⁶

Consultation questions

11. What information should registered entities be required to disclose to ensure good governance procedures are in place?
12. Should the remuneration (if any) of responsible individuals be required to be disclosed?
13. Are the suggested criteria in relation to conflicts of interest appropriate? If not, why not?
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)?
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'?

6.3 RISK MANAGEMENT

127. What processes an entity has in place to identify fraud or mission drift, to ensure that it is still operating in accordance with its governance rules, and ensure that it is complying with all relevant laws are important for entities operating for the public benefit, and receiving public benefits.
128. Many of the items discussed above impact on, and undoubtedly improve, the risk management processes of a NFP entity. For example, effective internal and external auditing processes and meeting requirements are methods to help ensure that a NFP entity is able to meet its financial requirements, and also to uncover transactions or agreements which may involve some inherent risk.
129. Given that NFPs are relied on by the community, and could represent the most vulnerable people, it is vital that NFPs have appropriate risk management strategies in place. The amount of detail and particular requirements in place will depend on the size of the entity, however all NFPs should have some procedures in place.
130. Over time an entity may slowly drift away from its mission without realising it, or expand, for example, to overseas jurisdictions to which it is not provided tax concessions to operate in. Adequate risk management strategies help to ensure the entity stays on target, and ensure that procedures are in place should issues or problems with current practices come to light.
131. Requirements may include having adequate procedures around reporting any breaches of various laws that may occur, rules around management of conflicts of interest and dispute

6 http://www.ourcommunity.com.au/management/view_help_sheet.do?articleid=757

resolution, ensuring OH&S practices are met, and ensuring the entity has any required insurance in place to protect against certain events such as a natural disaster, injury of a volunteer or fraud.

132. In addition, should an event of fraud occur, procedures need to be in place around who should bear the risk, and what processes should be followed.
133. Many of the model rules for incorporated associations provided by the states and territories provide arrangements for disputes and mediation. Victoria, for example provides model rules that include that parties to a dispute must meet and discuss the matter, and, if possible, resolve the dispute within 14 days after the dispute comes to the attention of all of the parties. If the parties are unable to resolve the dispute at the meeting, or if a party fails to attend that meeting, then the parties must, within 10 days, hold a meeting in the presence of a mediator.
134. PAFs impose requirements on trustees. Trustees must prepare an investment strategy in relation to the fund's assets. The strategy aims to ensure the long term protection of the fund's philanthropic assets. Imposing an obligation to put in place an investment strategy avoids the need to impose inflexible and prescriptive investment limitations upon the fund.
135. In addition, all Australian states and territories have enacted legislation governing the broad duties and responsibilities of trustees. For example, in NSW, the *Trustee Act 1925* provides that the trustee can invest funds in any form of investment, or vary the investment at any point in time, under certain conditions, such as diversification (section 14).
136. Insurance is an effective way to manage risk within an entity. NFP entities have different insurance needs to their corporate counterparts. Many insurance providers provide specific NFP insurance. The schemes contain different levels of cover, but some include: public liability insurance, directors' and officers' insurance, professional indemnity insurance, voluntary workers accident insurance, motor and property insurance.
137. Many NFPs would not be able to meet the costs associated with an unforeseen event, such as the injury of one of the NFP's volunteers. Donors make donations for the purposes of furthering their chosen charity's purpose, not to cover the legal or medical costs associated with an accident, or an event such as fraud.

Consultation questions

16. Given that NFPs control funds from the public, what additional risk management requirements should be required of NFPs?
17. Should particular requirements (for example, an investment strategy) be mandated, or broad requirements for NFPs to ensure they have adequate procedures in place?
18. Is it appropriate to mandate minimum insurance requirements to cover NFP entities in the event of unforeseen circumstances?
19. Should responsible individuals generally be required to have indemnity insurance?

6.3.1 Internal and external reviews

138. Reviews of procedures in NFP entities allows for increased transparency and a level of oversight to increase public confidence in the NFP sector.
139. Internal procedures, such as requiring two individuals to sign any cheques written, ensuring the books are prepared by an accountant and requiring large entities to have an audit committee help the entity increase transparency and safeguard against mismanagement.
140. Requiring an entity to have their accounts reviewed, whether by a registered auditor, by an independent reviewer, or by conducting an annual internal review (depending on the size of the entity and the amount of public money and concessions that it receives) will increase public confidence in the sector, and ensure the entities operations remain aligned with the NFP entities mission and cause, and ensure the level of oversight fitting of an entity in receipt of public monies, and operating for the public benefit.
141. Whether or not a company limited by guarantee is required under the Corporations Act to have their accounts audited depends on the size of the entity.
142. A 'small' company limited by guarantee (annual revenue less than \$250,000 which do not have DGR status) does not have to prepare a financial report or have it audited, prepare a directors' report, or notify members of annual reports.
143. A 'medium' company limited by guarantee (annual revenue less than \$250,000 that have DGR status, or companies with annual revenue between \$250,000 and \$1 million) must prepare a financial report, but can elect to have the financial report reviewed rather than audited. A directors' report must be prepared, with more streamlined disclosures, and the company must give annual reports to any member who elects to receive them.
144. A 'large' company limited by guarantee (those with annual revenue of \$1 million or more) must prepare a financial report, and get the report audited. They must also prepare a directors' report, with more streamlined disclosures, as well as providing the annual report to any member who elects to receive them.
145. Auditors are required to audit against the accounting standards in accordance with the auditing standards.

146. Incorporated associations may also currently be required to have their financial statements audited annually. Auditing requirements are linked to tier structures dependent on the size of the entity, with the tiers differing slightly between states.
147. For example, in NSW, Tier 1 associations (gross receipts exceed \$250,000 or current assets exceed \$500,000) are required to lodge audited financial statements and auditors reports with the Director-General annually. Victoria requires prescribed associations with annual gross revenue of more than \$200,000 or assets in excess of \$500,000 to lodge their annual financial reports in accordance with the relevant accounting standards with a signed auditor's report annually with the Registrar.
148. These audit requirements are usually focussed on financial audits, and not specifically on governance requirements that may need reviewing or auditing.
149. Entities registered under the CATSI Act are also required to have their accounts audited based on the size of the entity.
150. The private ancillary fund guidelines require that each financial year the trustee must arrange for an auditor (who must be registered) to audit:
- the financial statements of the fund; and
 - compliance with the PAF guidelines by the fund and the trustee.
151. While smaller NFP entities may not have the capacity or resources to have their accounts independently audited annually, requiring the current financial position of the entity to be internally or externally reviewed can lead to increased accountability and transparency.

Consultation questions

20. What internal review procedures should be mandated?

6.4 MINIMUM REQUIREMENTS FOR AN ENTITY'S GOVERNING RULES

152. Governing rules are those documents of an entity that set out a NFP's purposes and how it is to be run. It may be a constitution, association rules, cooperative rules, memorandum and articles of association, or a trust deed.
153. Governing rules cover a broad range of topics, including rules about an entity's mission, procedures when an entity winds up, what happens on de-registration, removal of members, how the governing rules can be altered and what happens when a responsible individual resigns from their position.
154. Currently, the Commissioner of Taxation accepts an entity as being NFP where its constituent or governing documents prevent it from distributing profits or assets for the benefit of particular people — both while it is operating and when it winds up. These documents should contain clauses providing for the entity's NFP character.
155. Incorporation under state or territory legislation appears to provide a less costly means for NFP associations to receive the status of a legal entity over registration under the Corporations

Act, and this has been reflected in the number of entities incorporated.⁷ NFP entities may also choose the incorporated association structure due to the ease of establishment. This is partly because the various state jurisdictions provide useful ‘templates’ which are easy to understand and complete.

156. The various states have similar templates. Using Victoria as an example, they have a model rules listed on the *Consumer Affairs Victoria* website. This document contains a ‘ready-made’ governing document, complete with places for the members to sign. The document contains standard definitions; provision for membership; arrangements for disputes and mediation; provision for annual general meetings, special general meetings and committee meetings; rules about office holders; rules about funds; provision for the winding up of the association, as well as other information relevant to the forming of an association.
157. The Corporations Act provides a framework whereby there are default rules which members automatically adopt unless they provide an alternative (the ‘replaceable rules’), and also rules which cannot be replaced (the ‘mandatory rules’) that apply to all corporations. These provisions have largely been adopted in the CATSI Act, although the corporation may be able to apply to the Registrar for exemption from some of them.
158. The CATSI Act includes a requirement for corporations to put in place rules or constitution that comply with a standard ‘rule book’. This establishes minimum governance measures but does allow for ‘replacement rules’ to accommodate differing needs. Importantly, the rule book stipulates that a number of ‘members’ rights’ (that are consistent with the Corporations Act) must be adopted. These include members’ rights to:
 - attend, speak and vote at general meetings;
 - be made a director;
 - put forward resolutions at general meetings;
 - ask the directors to call a general meeting; and
 - look at the books and records of the corporation (if the directors have authorised them to do this, or if the members have passed a resolution which lets them do this).
159. For PAFs, the governing rules are generally the trust instrument of the fund. A PAF is required to be set up and run solely to benefit other deductible gift recipients and the governing rules of the fund must contain this purpose. The Australian Taxation Office provides a model PAF trust deed.
160. The PAF guidelines include requirements such as that a PAF’s governing rules must include objects that clearly set out and reflect the purpose of the fund, it must be established and operated as a NFP entity, that the trustee of the fund must exercise the same degree of care, diligence and skill that a prudent individual would exercise in managing the affairs of others. The governing rules must also prohibit the fund from indemnifying the trustee, or an employee, office or agent for a loss of liability attributable to:

⁷ Sievers, Sally. 2001. *Incorporation and regulation of non-profit associations in Australia and other common law jurisdictions*. 13 *Australian Journal of Corporate Law*, p 10.

- dishonesty of the trustee, employee, officer or agent; or
- gross negligence or recklessness of the trustee, employee, officer or agent; or
- a deliberate act or omission known by the trustee, employee, officer or agent to be a breach of trust.

Consultation questions

21. What are the core minimum requirements that registered entities should be required to include in their governing rules?
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?
23. Who should be able to enforce the rules?
24. Should the ACNC have a role in the enforcement and alteration of governing rules, such as on wind-up or deregistration?
25. Should model rules be used?

6.5 RELATIONSHIPS WITH MEMBERS

161. Not all NFP entities (for example, charitable trusts) have members, so this section will not be applicable to all NFPs. However, amendments to the governance requirements may include meeting requirements, for entities which have members.
162. Having adequate procedures in place may include dealing with issues such as quorum at meetings, notice of general meetings and special meetings, special business, adjournment of meetings, minutes, voting and polls, proxies and requirements around committee meetings.
163. Dispute resolution is also another important part of dealing with the relationships with members. Procedures should be in place for dealing with disputes among members, to ensure they are resolved fairly, quickly and efficiently as possible. In addition, should an event of fraud occur, procedures need to be in place around who should bear the risk.
164. As discussed elsewhere in this document, incorporated associations have different requirements depending on what jurisdiction they are governed by. However, all jurisdictions require an annual general meeting to be held once every calendar year, and for minutes to be kept of all committee and general meetings.
165. In regard to Aboriginal and Torres Strait Islander corporations, the CATSI Act contains a chapter (Chapter 5) on how meetings for these corporations may be conducted. Under this Act, there are two kinds of meetings: directors' meetings and general meetings. Some of the rules in Chapter 5 can be modified (they are 'replaceable rules'), whereas others cannot. The rules are extensive, so some significant ones are discussed below.
 - 165.1. Part 5.2 deals with general meetings. An Annual General Meeting must be held every year, and a general meeting must be called if a certain number of members request it;

- 165.2. The Chapter also sets out rules governing the use of proxies and how voting is to be conducted during meetings. These largely reflect the Corporations Act provisions.
- 165.3. Part 5.3 deals with directors' meetings, and provides that the constitution of an Aboriginal and Torres Strait Islander corporation must specify how often directors' meetings are to be held. A director may call a directors' meeting by giving reasonable notice to the other directors. The quorum for a directors' meeting is a majority of the directors present for the whole meeting, and a resolution is passed by a majority of the votes cast by those directors entitled to vote.
- 165.4. Part 5.4 contains requirements for keeping Minutes of general meetings and directors' meetings.
- 165.5. Part 5.5 provides that the Registrar is able to exempt corporations from the requirements of the chapter, for example, for small corporations where there is no need or capacity to hold a meeting.
166. It appears reasonable to include meeting requirements in the governance requirements of NFP entities. General meetings and meetings of responsible individuals (or directors) provide a useful forum to monitor the operations of the entity, and bring to light issues which may not surface otherwise.
167. A requirement to keep minutes of the meetings also provides records so that future people involved in the entity can be informed of past issues and how these were resolved. These requirements also keep the responsible individuals accountable for their decisions.
168. Currently, there are no meeting requirements for unincorporated associations.

Consultation questions

26. What governance rules should be mandated relating to an entity's relationship with its members?
27. Do any of the requirements for relationships with members need to apply to non-membership based entities?
28. Is it appropriate to have compulsory meeting requirements for all (membership based) entities registered with the ACNC?

7. SUMMARY

169. The discussion above raises broad questions in regard to the appropriate governance requirements for NFPs and charities wishing to be registered by the ACNC. Although some charities are small and may have limited resources, it is important to ensure that all entities operate under appropriate and proportionate governance requirements because they all receive government and public support, and must therefore be accountable to the public which they serve.
170. Principles-based requirements will allow NFPs to tailor the requirements to their specific needs, while still ensuring good governance practices and promoting transparency.
171. The government is seeking views for whether governance reforms could apply across all NFP entities, to standardise regulation and simplify compliance.
172. We are also interested in hearing from Indigenous stakeholders on their views on governance and the need for reform.

Consultation questions

29. Are there any types of NFPs where specific governance arrangements or additional support would assist to achieve in better governance outcomes for NFPs?
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?
31. What principles should be included in legislation or regulations, or covered by guidance materials to be produced by the ACNC?
32. Are there any particular governance requirements which would be useful for Indigenous 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?

APPENDIX I: INTERNATIONAL COMPARISONS

7.1 ENGLAND AND WALES

173. The United Kingdom (UK) has undertaken several reviews of corporate governance arrangements over the past two decades. The Cadbury Report of 1992, delivered by Sir Adrian Cadbury, represented the first attempt to formalise corporate governance best practice in a written document. It set the agenda for corporate governance reform in the UK, including the development of guidelines and codes of practice. While directed at for-profits, the outcomes of the report, and subsequent reports, impacted on and influenced the development of governance frameworks for NFPs in the UK as well, such as the formation of audit committees and the reporting on the effectiveness of internal controls.
174. The establishment of the Charities Commissions of England and Wales, Scotland and Northern Ireland have further improved governance frameworks for the NFP sector. The Charities Commissions take a risk based and proportionate approach to regulating charities.⁸
175. The Commission of England and Wales has developed a principles based approach to governance, and has issued advice in *Good Governance: a Code for the Voluntary and Community sector*.⁹ The six high level principles are (followed by sub-principles and supporting advice):

| Principle 1 | Principle 2 | Principle 3 |
|--|---|---|
| <i>An effective board will provide good governance and leadership by understanding their role.</i> | <i>An effective board will provide good governance and leadership by ensuring delivery of organisational purpose.</i> | <i>An effective board will provide good governance and leadership by working effectively both as individuals and as a team.</i> |
| <p>Members of the board will understand their role and responsibilities collectively and individually in relation to:</p> <ul style="list-style-type: none"> • their legal duties; • their stewardship of assets; • the provision of the governing document; • the external environment; and • the structure of the organisation. | <p>The board will ensure that the organisation delivers its stated purpose or aims by:</p> <ul style="list-style-type: none"> • ensuring organisational purposes remain relevant and valid; • developing and agreeing a long term strategy; • agreeing operational plans and budgets; • monitoring progress and spending against plan and | <p>The board will have a range of appropriate policies and procedures, knowledge, attitudes and behaviours to enable both individuals and the board to work effectively. These will include:</p> <ul style="list-style-type: none"> • finding and recruiting new board members to meet the organisation’s changing needs in relation to skills, experience and diversity; • providing suitable induction for new board members; |

8 http://www.charity-commission.gov.uk/Our_regulatory_activity/Our_approach/default.aspx

9 http://www.charity-commission.gov.uk/Library/guidance/good_governance_full.pdf

| | | |
|--|--|--|
| | <ul style="list-style-type: none"> budget; evaluating results, assessing outcomes and impact; and reviewing and/or amending the plan and budget as appropriate. | <ul style="list-style-type: none"> providing all board members with opportunities for training and development according to their needs; and periodically reviewing their performance both as individuals and as a team. |
|--|--|--|

| Principle 4 | Principle 5 | Principle 6 |
|---|--|---|
| <i>An effective board will provide good governance and leadership by exercising effective control.</i> | <i>An effective board will provide good governance and leadership by behaving with integrity.</i> | <i>An effective board will provide good governance and leadership by being open and accountable.</i> |
| <p>As the accountable body, the board will ensure that:</p> <ul style="list-style-type: none"> the organisation understands and complies with all legal and regulatory requirements that apply to it; the organisation continues to have good internal financial and management controls; it regularly identifies and reviews the major risks to which the organisation is exposed and has systems to manage those risks; and delegation to committees, staff and volunteers (as applicable) works effectively and the use of delegated authority is properly supervised. | <p>The board will:</p> <ul style="list-style-type: none"> safeguard and promote the organisation's reputation; act according to high ethical standards; identify, understand and manage conflicts of interest and loyalty; maintain independence of decision making; and deliver impact that best meets the needs of beneficiaries. | <p>The board will lead the organisation in being open and accountable, both internally and externally. This will include:</p> <ul style="list-style-type: none"> open communications, informing people about the organisation and its work; appropriate consultation on significant changes to the organisation's services or policies; listening and responding to the views of supporters, funders, beneficiaries, service users and others with an interest in the organisations' work; handling complaints constructively, impartially and effectively; and considering the organisation's responsibilities to the wider community, for example, its environmental impact. |

Risk Management

176. Concerning risk processes, charities in England and Wales do not have to adopt any specific approach to risk management. In particular the Charity Commission, whilst believing there is a need for trustees to comment on their management of risk, has not provided any specific

guidance in this area, and therefore it is up to each charity to decide the best approach for its own particular circumstances.¹⁰

Insurance

177. Section 39 of the *Charities Act 2006* states that the charity ‘may arrange for the purchase, out of the funds of the charity, of insurance designed to indemnify the charity trustees or any trustees for the charity against any personal liability’ for any breach of trust or breach of duty committed by them in their capacity as charity trustees or trustees for the charity, or any negligence, default, breach of duty or breach of trust committed by them in their capacity as directors or officers of the charity.¹¹

177.1. However the terms of the insurance is not allowed to indemnify the person for any liability incurred in criminal proceedings, or regulatory authority penalties.

178. Section 35 of the *Charities Act 2006* sets out four conditions to be met in order for the remuneration of trustees to be considered acceptable. The conditions are not onerous, and do not limit the amount that can be provided in remuneration.

179. The conditions instead dictate that the amount or maximum amount of the remuneration be set out in writing between the charity or its charity trustees, that the amount does not exceed what is reasonable in the circumstances for the provision by that person of the services in question, and that before entering into that agreement, the charity trustees decided that they were satisfied that it would be in the best interests of the charity for the services to be provided by the relevant person to or on behalf of the charity for the amount or maximum amount of remuneration set out in the agreement.

Audit

180. The governance requirements include that¹² all charities must prepare accounts and that an annual return and a trustee’s annual report must be lodged with Commission if income exceeds £10,000.

181. Auditors of non-company charities are required to report to the Commission. This requirement is set out in section 44A of the *Charities Act 1993* which was inserted by section 29 *Charities Act 2006* (UK).

181.1. Tiers of audit reporting have been set out in regulations issued by the Charity Commission, and can be altered overtime to reflect societal expectations and requirements.

182. Auditors under the *Charities Act 2006* are required to make a written report to the Commission if in the course of acting as an auditor for a charity they become aware of a matter which relates to the activities or affairs of the charity, or of any connected institution or

10 Horwath Clark Whitehill, <http://fp04-586.web.dircon.net/sector/noprofit/charities/RiskMan.pdf>

11 S39, *Charities Act 2006*, http://www.legislation.gov.uk/ukpga/2006/50/pdfs/ukpga_20060050_en.pdf

12 <http://www.charity-commission.gov.uk/Publications/cc15a.aspx>

body, and has reasonable cause to believe the activity or affairs is likely to be of material significance for the purposes of the exercise by the Commission.¹³

7.1.1 Duties of Trustees

183. The duties of charitable trustees are set out in the *Trustee Act 2000*, and both the *Charities Act 1993* and *Charities Act 2006*.
184. Under the *Trustee Act 2000* the first duty of a trustee is that of duty of care, which applies to trustee when exercising the general power of investment, entering into an arrangement on behalf of the entity, and when carrying out a duty to which they are subject.
185. For the purposes of the Charity Commission, it considers that anyone that is responsible for the management of a charity is considered to be a charity trustee. This is set out in the *Charities Act 1993* (need to find section with definition).
186. The duties of charitable trustees in the UK also include the common law fiduciary duties. These apply to 'charity trustees' no matter what the type of entity (that is, company, trust or incorporated entity).

7.1.2 Charitable Companies

187. The responsibilities of charitable companies were subject to changes by the *Companies Act 2006*.¹⁴ The changes to the *Companies Act 2006* identified new duties for directors, including a duty to act in good faith and a way which would most likely to achieve the purposes of the company (s.172 of the *Companies Act 2006*).
188. The *Companies Act 2006* also effects charitable companies with respect to conflicts of interest. The Act places a specific statutory duty on directors to avoid a situation in which they have, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company (s.175(1) of the *Companies Act 2006*). Conflicts of interest include those arising from any personal financial interest in a transaction with the charity — for example, where a director receives payment from the charity for services or goods — and those which do not involve any material benefit to a director, for example, where a director is also a charity trustee of another charity which might be in competition with the charity (also known as conflicts of loyalty).¹⁵
189. In the case of a charitable company, the *Companies Act 2006* duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company if this is permitted by the company's articles of association (s.175(3) of the *Companies Act 2006* as modified for charitable companies by s.181).
190. The *Companies Act 2006* dictates that the minimum age for directors is 16 years.

13 S 29, *Charities Act 2006*, <http://www.legislation.gov.uk/ukpga/2006/50/contents>

14 http://www.charity-commission.gov.uk/charity_requirements_guidance/charity_governance/good_governance/compact.aspx?

15 http://www.charitycommission.gov.uk/charity_requirements_guidance/charity_governance/good_governance/compact.aspx

191. Permission for any alteration to a company's objects clause is only needed where the alteration will specifically add, remove or alter the statement of the objects themselves. Any change to the objects does not take effect until registered by Companies House. It is the directors' responsibility to let the Charity Commission know the date on which Companies House registered their amended objects.

7.1.3 Charitable Incorporated Organisation

192. The *Charities Act 2006* has included a new legal structure for charities, the charitable incorporated organisation (CIO).¹⁶ This legal form was designed specifically for charitable organisations, and overcomes the disadvantages inherent in an unincorporated structure, and the dual reporting obligations required of incorporation as a company limited by guarantee.¹⁷

193. CIO's will need to report only to the Charities Commission, and will be subject to less stringent compliance obligations. For example, financial reporting obligations are to be based on the size of the entity.¹⁸ The broader provisions governing CIO's are contained within the Charities Act and CIO Regulations.

194. The regulations which complete the legal and governance framework for CIOs have yet to be debated by the UK Parliament, and subject to Parliament approving the regulations, the CIO structure should be available for charities to start using from Spring 2012.¹⁹ Scotland and Northern Ireland have also included the CIO as a legal form.²⁰

7.1.4 Charitable Trusts

195. The Charities Commission is responsible for regulating charitable trusts, and seeks to ensure that trustees comply with their legal obligations in managing charities, and identifies and investigates abuse and mismanagement in charities.²¹ The involvement of the Commission has not only improved the governance of charitable trusts, but has removed the need for judicial intervention by the Attorney-General, thus enhancing efficiency.

196. The duties of charitable trustees are set out in the *Trustee Act 2000*. The first duty of a trustee is that of duty of care, which applies to trustee when exercising the general power of investment, entering into an arrangement on behalf of the entity, and when carrying out a duty to which they are subject.

7.2 NEW ZEALAND

197. New Zealand established a Charities Commission in 2005. The Charities Commission requires certain levels of governance requirements from charities.

16 Charities Act 2006 (UK), s 34.

17 http://www.charity-commission.gov.uk/Start_up_a_charity/Do_I_need_to_register/Charitable_Incorporated_Organisations_index.aspx

18 <http://www.caplus.org.uk/system/files/3+CIO+handout.doc>

19 http://www.charitycommission.gov.uk/Start_up_a_charity/Do_I_need_to_register/CIOs/when_can_i_register.aspx

20 Charities and Investment Act (Scotland) 2005, Ch 7; Charities Act (Northern Ireland) 2008, Pt 11.

21 <http://www.charities-commission.gov.uk>

198. An organisation's rules are not required to contain certain words in order to consider the organisation to be charitable. However, the Commission must be satisfied that the organisation meets certain criteria. They examine the rules of the organisation through the application process, and an organisation must notify the Commission in advance of any changes to those rules.
199. Examples of an entity's rules are the document or documents that set out its purposes, what it does, and how it operates. They may be the governing document, constitution, trust deed, charter, or an Act of Parliament. The Commission provides advice on what the rules could contain.²²
200. The Charities Commission requires that all charities file annual returns with Charities Commission (section 41). Incorporated societies do not need to send annual returns to Companies Office, but only to the Charities Commission, thereby reducing their compliance burden.²³
201. There is currently no requirement for an audit to be done of the annual return. However, if an audit has been conducted then it must be included in the filing an annual return.
202. While the Charities Commission has done a lot to streamline reporting and governance requirements, entities are still subject to separate regulation under the *Charitable Trusts Act 1957* or the *Incorporated Societies Act 1908*.

7.2.1 Incorporated Associations

203. New Zealand's Incorporated Societies Act 1908 provides a means for associations with fifteen or more members to register with the Companies Office as an incorporated association.²⁴ However, in order to be eligible for tax concessions, an incorporated association must also register with New Zealand's Charities Commission.²⁵
204. The *Incorporated Societies Act 1908* stipulates the required rules of a society in its governing documents (section 6). They must contain:
- a) the objects for which the society is established;
 - b) the modes in which persons become members of the society;
 - c) the modes in which persons cease to be members of the society;
 - d) the mode in which the rules of the society may be altered, added to, or rescinded;
 - e) the mode of summoning and holding general meetings of the society, and of voting thereat;
 - f) the appointment of officers of the society;

22 <http://www.charities.govt.nz/news/information-sheets/rules-and-the-charities-act/>

23 <http://www.charities.govt.nz/LinkClick.aspx?fileticket=Lw6tvA8lZwI%3d&tabid=218&mid=835>

24 Incorporated Societies Act 1908 (NZ), s 4.

25 <http://www.charities.govt.nz/LinkClick.aspx?fileticket=xAFkAv9ymyo%3d&tabid=218&mid=835>

- g) the control and use of the common seal of the society;
- h) the control and investment of the funds of the society;
- i) the powers (if any) of the society to borrow money;
- j) the disposition of the property of the society in the event of the society being put into liquidation; and
- k) such other matters as the Registrar may require to be provided for in any particular instance.

7.2.2 Charitable Trusts

205. In New Zealand, charitable trusts are registered as legal entities under the *Charitable Trusts Act 1957* (NZ),²⁶ and as charities under the *Charities Act 2005* (NZ). Registering under the *Charitable Trusts Act 1957* (NZ) allows trustees the benefits of incorporating as a Charitable Trust Board. A Board is able to sue and be sued, and is subject to all the rights and liabilities of a body corporate.²⁷
206. The *Charities Act 2005* denotes the powers and responsibilities of the Charities Commission, but the Attorney-General retains the authority to approve cy près schemes in relation to trusts.²⁸ Similarly the powers of trustees remain governed by the *Trustee Act 1956* (NZ). These reforms have reduced the compliance and administrative costs associated with the regulation and supervision of charitable trusts. While there are rules around issues such as ‘vesting property in the trustee’ and ‘incorporation of trust boards’, there is little in the way of direct regulations for charitable trusts contained in the Act itself.

7.3 UNITED STATES

207. The United States (US) has a number of different levels of governance requirements, both at the Federal and State levels.
208. In response to the collapse of a number of large corporations, the US in 2002 passed the *Sarbanes-Oxley Act*, requiring companies to adhere to new governance standards. While its purpose was to rebuild public trust in America’s corporate sector, it also served as a wake-up call for the NFP sector.²⁹ Two provisions of the *Sarbanes-Oxley Act* apply to all entities, including NFPs.
209. The first provision is the Independent and Competent Audit Committee, which requires that each member of a company’s audit committee be a member of the board of directors and be independent. ‘Independence’ in the Act is defined as not being part of the management team and not receiving any compensation (either directly or indirectly) from the company as a consultant for other professional services, though board service may be compensated.

26 <http://www.charities.govt.nz/LinkClick.aspx?fileticket=xAFkAv9ymyo%3d&tabid=218&mid=835>

27 *Charities Act 2005* (NZ), s13.

28 *Charitable Trusts Act 1957*, Parts 4 and 5.

29 http://www.boardsource.org/dl.asp?document_id=558

210. The second provision relates to the responsibilities of auditors. The *Sarbanes-Oxley Act* requires that the lead and reviewing partner of the auditing firm rotate off of the audit of an entity every five years. Further, the Act prohibits the auditing firm from providing most of any non-audit services to the company concurrent with any auditing services. This ban applies to bookkeeping, financial information systems, appraisal services, actuarial services, management or human resource services, investment advice, legal services, and other expert services unrelated to the audit.³⁰
211. Charitable trusts are generally formed at the state or provincial level but can receive tax exempt status from the federal government. A number of efforts towards adopting uniform laws in the United States have been attempted with the *Uniform Supervision of Trustees for Charitable Purposes Act 1954* and the *Uniform Trusts Code 2000* however these have not been adopted by a significant number of states.
212. There is no evidence to suggest that the US or any of its States require that not-for-profits hold any particular level of insurance cover to indemnify themselves.
213. The US as part of its reporting requirements for NFPs is that they attach Schedule A to their Form 990 or 990-EZ return. Schedule A is used to report information that is not open for public disclosure, including information about the compensation of officers, employees, and independent contractors.
214. Non-profits are required to make certain tax documents available for public inspection. The three most recent information returns (Form 990 or 990-EZ) and its application for exempt status (Form 1023) must be made available for inspection upon request. If the request is made in person, it must generally be honoured on the day of the request; if it is written, then the organisation generally has 30 days to respond.³¹
- 214.1. Responsible persons of a tax-exempt organisation who fail to provide the documents as required may be subject to a penalty of \$20 per day for as long as the failure continues. There is a maximum penalty of \$10,000 for each failure to provide a copy of an annual information return.

7.3.1 California Nonprofit Integrity Act 2004

215. The state of California has enacted the *Nonprofit Integrity Act 2004*.³² This places certain restrictions on non-profit entities within the Californian jurisdiction.
216. The Act requires that charitable corporations, unincorporated associations and trusts file with the State Attorney General articles of incorporation, or other documents governing the organisation's operations.
217. If an entity has gross revenue greater than \$2 million, it must establish an audit committee and prepare annual financial statements audited by an independent certified public accountant.

30 http://www.boardsource.org/dl.asp?document_id=558

31 <http://www.irs.gov/charities/article/0,,id=135012,00.html>

32 http://ag.ca.gov/charities/publications/nonprofit_integrity_act_nov04.pdf

217.1. The audit committee cannot include staff members, the president or chief executive officer, the treasurer or chief financial officer of the organisation, and if an organisation has a finance committee chairperson of the audit committee cannot also be a member of the finance committee.

218. The Act also dictates that charitable corporations and unincorporated associations must have their governing board or authorised board committee review and approve the compensation of the Chief Executive Officer or President, and the compensation of the Chief Financial Officer or treasurer, to ensure that the payment is 'just and reasonable'.

218.1. Review and approval of compensation must occur at the time of initial hiring, when the term is renewed or extended, and when the compensation is modified. Compensation also includes any other benefits provided to the person.

7.4 CANADA

219. Canada has a two-tier regulatory structure, with the Charities Directorate in the Canada Revenue Agency (CRA) acting as the primary regulator of charities, and the provinces possessing authority over the law of trusts. Charities are registered with the CRA and are required to file an annual information return in order to retain registered status.³³

219.1. Charitable trusts are generally formed at the state or provincial level but can receive tax exempt status from the federal government.'

220. The *Canada Not-for-profit Corporations Act* enacted in 2009 requires certain levels of disclosure by directors and officers of NFPs (s141 of the Act). Disclosure of interests by a director or officer must be in writing or by requesting to have it entered in the minutes of meetings, and detail the nature and extent of any interest that the director or officer has in a material contract or material transaction, whether made or proposed if the director or officer:

- is a party to the contract or transaction;
- is a director or an officer, or an individual acting in a similar capacity, of a party to the contract or transaction; or
- has a material interest in a party to the contract or transaction.

221. The Charities Directorate requires that registered charities must file an annual information return (T3010), which includes financial statements and who the directors/trustees are. Registration as a charity for tax exempt status can be revoked if the information return is not filed within 6 months after the end of the charity's financial year.³⁴

222. The *Canada Not-for-profit Corporations Act* also out who is disqualified from being a director of a not-for-profit corporation:

- anyone who is less than 18 years of age;

33 <http://www.cra-arc.gc.ca/chrts-gvng/chrts/prtnng/rtrn/menu-eng.html>

34 <http://www.cra-arc.gc.ca/chrts-gvng/chrts/prtnng/rtrn/cnsqncs-eng.html>

- anyone who has been declared incapable by a court in Canada or in another country;
- a person who is not an individual; and
- a person who has the status of a bankrupt.

223. The Charities Directorate requires that registered charities must file an annual information return (T3010), which includes financial statements and who the directors/trustees are. Registration as a charity for tax exempt status can be revoked if the information return is not filed within six months after the end of the charity's financial year.³⁵

223.1. Most of the charity's information return and all of the financial statements are available to the public. The public parts of a charity's return are posted on the CRA Web site.

223.2. The *Canada Not-for-profit Corporations Act* specifies that financial statements must be disclosed to members and presented to the annual meeting.

224. If the registered charity has income over \$250,000 the Charities Directorate recommends that financial statements be professionally audited, otherwise, the treasurer for the charity should sign them.

35 <http://www.cra-arc.gc.ca/chrts-gvng/chrts/prtnng/rtrn/cnsqncs-eng.html>