



**The Fred Hollows  
Foundation**

ACN 070 556 642

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Dear Manager

**Re: Review of Not-for-Profit Governance Arrangements – Consultation Paper**

The Fred Hollows Foundation appreciates the opportunity to contribute our views on the important issues contained in this consultation paper and on the NFP reform agenda more broadly.

The attached submission provides both general overarching comments as well as responses to the specific questions posed in the paper.


Please do not hesitate to contact me if you require clarification or further information on any matter we raise.

Yours sincerely

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 <b>The Fred Hollows Foundation</b>	<b>Review of Not-for-Profit Governance Arrangements</b>  <b>Submission to Treasury - January 2012</b>
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## **PART A: GENERAL OVERARCHING COMMENTS OR ISSUES**

The Fred Hollows Foundation (FHF) welcomes and supports the current NFP reform process and is hopeful that it will produce positive outcomes. We are encouraged by the Government's commitment to strengthening the non-for-profit (NFP) sector in Australia and public confidence in its operations, at the same time as centralising and simplifying the complex regulatory system that currently governs it.

Achieving this dual goal will require getting the balance right between enhancing accountability and transparency on the one hand and cutting red tape and duplication on the other.

The Foundation makes the following general comments about the balance that should be struck if the reform process is to produce benefits for the most important stakeholders – the individuals and communities supported and served by NFP organisations.

### **1. Consolidating the consultation process**

A daunting number of draft bills and consultation papers have been released for public comment in a concentrated period of time, with more on the immediate horizon. Input is being invited through different mechanisms and processes which are or will be conducted by different agencies. Yet the issues under discussion are interconnected and do not lend themselves easily to separate treatment.

FHF therefore urges The Treasury and the Implementation Taskforce of the Australian Charities and Not-for-Profit Commission (ACNC) to convene consolidated face-to-face consultation sessions which are also attended by other key players in the reform process such as the ATO and ASIC. This approach would both ease the participatory burden for interested parties and lead to a sharper examination and treatment of the linkages between the issues under consideration.

### **2. Centralising and simplifying the existing regulatory system**

FHF is well aware of the need to centralise and simplify the regulatory arrangements that apply to the governance of NFPs. We are a relatively sophisticated and well-resourced organisation and yet find it difficult to keep abreast of the compliance obligations imposed on us by a range of commonwealth and state/territory regulatory authorities, each with its own reporting

requirements, templates and timelines. Smaller and poorer organisations must seriously struggle to do so.

The administrative burden posed by this complexity not only detracts from the ability of organisations to fulfill their core purpose but is perverse in that it can directly contribute to non-compliance and less-than-optimal governance.

We therefore submit that the reform goal of reducing compliance and administrative costs must be given equal weight to the goal of enhancing transparency and accountability. These two goals need to be understood as complementary, not contradictory. Our members and donors want to see both, and the wise use of public and donated funds demands both.

It is also important that the call for a lighter compliance burden and more streamlined reporting is not seen as special pleading by the sector. The Government has already made reducing red tape a central goal in its dealings with commercial for-profit entities, and requires agencies such as the Australian Bureau of Statistics to monitor the number and scope of reports it requires from different industries and to reduce the compliance burden it imposes. It is both logical and fair that the same approach be adopted in relation to NFP entities.

FHF is therefore strongly supportive of the consultation paper's statement that *"it is intended that all the organisation governance requirements for NFP entities will be centralized through the ACNC"* (page viii). However as discussed in this submission, we are concerned that the consultation paper contains some proposals which, if adopted, would seriously undermine this positive goal.

### **3. Taking a phased approach**

Translating the intent of centralisation into reality will be a complex task – one that the consultation paper largely skates over. This is not surprising given that much of the consultation and negotiation around moving to a single regulatory portal and a "report once" model is either still in train or still needs to be commenced. For example, reviews of companies limited by guarantee and of fundraising legislation have been flagged for 2012 but no documents have yet been released. Yet these will also be considering governance and reporting requirements. Even when these consultations are concluded, there will doubtless be a protracted period of negotiation between agencies at both Commonwealth and State/Territory levels before agreement on a cooperative streamlined regulatory system is achieved.

Given this scenario and to avoid the risk of torpedoing one of the main reform goals, FHF submits that a minimalist approach should be taken to governance arrangements at this point (such as requiring only that the core fiduciary duties as set out in general law be met and that the organisation fulfills its purpose to the best of its ability in all the circumstances). The goal should be to first legislatively establish the ACNC with minimal governance requirements placed on registered entities and, in a second developmental phase, embark on a more considered and collaborative process to determine whether a more expansive set of specific NFP governance requirements is desirable or warranted. In our view this should be a genuinely open question.

Such a staged approach is defensible as there is, to our knowledge, no solid evidence of intrinsic or pervasive bad governance practice in NFP organisations. There may not be widespread best practice but there is generally good enough practice. Improvement is desirable but not urgent.

#### **4. Delivering on the principles-based approach**

The consultation paper is cognisant of the issues raised above but suggests the pitfalls can be avoided by adopting “...*some high-level principles based mandatory requirements for registered entities, as well as some good practice guidelines*” (page viii).

FHF is strongly supportive of a principles-based model, especially one buttressed by “if not, why not” reporting templates. However our confidence that this approach will actually eventuate was shaken as we progressed through the paper.

First, the language became increasingly that of “Model Rules” rather than “Principles”. This is not just a question of semantics. If expressed as rules there is a much greater chance that NFPs will feel compelled to adopt them in every element, even if there are valid reasons not to do so. More significantly, it is likely that pressured staff in the regulatory authority will be tempted to reject reports or submissions which do not conform precisely to the wording or letter of the model rules rather than taking the time to assess whether the principles contained in those rules are met albeit in a different way.

Second, many of the mooted proposals are so detailed that they cumulatively create the impression that the end-result will be a Code of Practice rather than a set of Governance Principles backed by a relatively small set of mandatory requirements and guidance notes. This would be a bad outcome. It would not only increase compliance burden but be futile. The breadth and diversity of the not-for-profit sector in Australia cannot be strait-jacketed within the confines of a single practice code. This is already evidenced by the fact that different sub-sectors have initiated their own self-regulatory codes which are legitimately quite different because they address the particular concerns, priorities and risks of their respective fields.

FHF has been intimately involved in the recent revision of the ACFID Code of Conduct and we know how difficult it is not to drift from principle to prescription even in this relatively small field of international development agencies. There is always a tendency to over-reach (with the proposal in this paper to mandate certain types of insurance being a good example) and to impose a single model of “best practice” rather than to accept that there are many “good practices” even within a single field of endeavour.

This is yet another reason to take a more modest and minimalist approach – not only at this stage of the reform process but at a later point when (as we are suggesting) a final decision is taken on whether a set of common governance requirements that go beyond the core fiduciary duties should be imposed on this very diverse sector and, if so, what they should be.

## **PART B: COMMENTS IN RESPONSE TO SPECIFIC 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?***

At most, this should be expressed only in the broadest terms such as the organisation's "charter", "mission", "constituency" and/or "stakeholders". The primary duty of responsible individuals is to implement their organisation's purpose or mission and to continually test their activities against this. Even this duty is not uncomplicated as the mission often needs re-interpreting and refining to ensure it remains relevant to contemporary circumstances. FHF, for example, has several times in its organisational development redefined its role and purpose in terms of our work with Indigenous communities in Australia.

### **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?***

As a membership-based organisation we note first that the potential list above does not include members – an omission which simply highlights the pitfalls of attempting to be definitive.

FHF therefore submits that the legislation should not attempt to prescribe a list as such an approach is not amenable to:

- the diversity of the sector;
- the distinctive and different purposes of each of its sub-sectors;
- the particular circumstances of individual organisations which can moreover change through the course of their development.

However if this position is not adopted, then the legislation should explicitly recognise that NFPs have multiple accountabilities. Within these, primacy should be given to the purpose/mission and to the beneficiaries or constituency of the organisation.

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

The ACNC legislation should do no more at this stage than outline the core fiduciary duties as established in general law. It could also make reference to the obligation on responsible individuals to fulfil any other duties imposed on them by the governing instrument of their organisation.

### **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?***

The standard should be that of a reasonable person exercising due diligence and care, with some reference to proportionality in terms of the size of the organisation and the conditions under which it operates.

There should be no prescriptive hierarchy of care duties for either members of the governance body or of the management team. This would be illogical as best practice in governance, for example, says that the board should act "as a whole" in all key decisions.

**5. *Should responsible individuals be required to hold particular qualifications or have particular experience or skills (tiered depending on size of the NFP entity or amount of funding it administers)?***

No. This is not required of the directors of for-profit organisations and there is no justification for imposing it on NFPs. Qualifications are a very blunt risk-management tool.

Moreover imposing such a requirement would reduce the potential pool of NFP directors in many localities and types of organisations – a perverse and counterproductive result when the aim is to strengthen the sector.

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

No. The responsible individuals collectively share responsibility for the entity.

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

The answer depends on the scope of the standardisation which is envisaged. If restricted to core fiduciary duties and fulfilling the organisation’s purpose to the best of its abilities in all the circumstances, then this is achievable. If the scope goes beyond this, then a myriad of issues will arise which need wider consultation with the sector and negotiated agreements with other existing regulators.

**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?***

Many of the volunteers in the NFP sector would already be classified as “responsible individuals” as they are unpaid board members. Those who are not in this classification should not have extra requirements imposed on them by this specific legislation.

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

It would be extremely difficult if not impossible to identify and legislatively define robust and generally applicable criteria for “higher risk” and we suggest it should not be attempted. Doing so would undermine the key message which needs to be sent by regulators and understood by the regulated, namely that all organisations in all areas of endeavour are at risk of non-performance, fraud, negligence or misconduct – whether they be big or small, operating only in Australia or also overseas, for-profit or not-for-profit.

However the educative arm of the ACNC can and should help skill-up NFPs to identify, manage and mitigate their risks.

**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?***

As previously discussed, our preference is to use core fiduciary duties as set out in general law at this stage.

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

The base level should be that all registered entities are required to make available their governing instrument(s). There may also be a case for requiring all entities to make their annual accounts available, though it should be noted that the Corporations Act does not require this of companies limited by guarantee that have annual revenue of less than \$250,000.

Other than the base level, entities should only be *required* to disclose information demanded of them through any other legislation by which they are bound. For example, if the entity is required to have audited annual accounts then it must disclose information as required in the applicable Accounting Standards.

If the decision is made that extra disclosure is required, then it is critically important that such requirements be proportional.

Beyond any mandatory requirements, the ACNC can and should have a role in encouraging registered entities to make publicly available a wide range of information in the interests of enhancing transparency and accountability but this should not be legislated nor should it be mandatory.

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

FHF does not believe that giving primacy to this component of expenditure is the best measure of an organisation's fiscal responsibility. In the area of regulation of NFPs, a better measure would be to require a statutory declaration signed by the Chair of the board and the CEO (if one exists) that there has been no breach of the prohibition on the distribution of profits.

There could also be a requirement on membership-based bodies that any remuneration of members of a governing body that relate solely to their role as governors must be first approved by an AGM of members (as currently provided for in the ACFID Code of Conduct).

If the entity is obliged by legislation to provide audited Annual Accounts, then the remuneration disclosures required by the relevant Accounting Standards should be contained there and not drawn out as a separate component.

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

In accordance with our earlier comments, FHF is not persuaded that across-the-board legislative requirements for all NFP organisations should impose conflict of interest obligations that go beyond those already established in general fiduciary duties (which include a duty to avoid conflicts of interest).

If the ACNC decides to go beyond this, then the most that should be legislatively required is that registered entities have a conflict of interest policy. The precise components of this policy should not be prescribed although the ACNC could and should provide guidance on what it may contain.

**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)?***

This should not be incorporated in general legislation that is intended to apply to all NFPs. It is best placed where it is now, that is in specific legislation such as the Corporations (Aboriginal and Torres Strait Islander) Act 2006.

**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’?***

See comments in 13 and 14 above. However if a specific obligation is to be imposed then it should be in relation to material personal interest.

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

FHF takes issue with the implication in this question that only NFP organisations control funds from the public. Most small and large for-profit organisations also receive public funds either in the form of subsidies, concessions and the like paid from public revenue or in the form of monies paid by individual members of the public for goods or services.

Given this, we do not believe that legislation should impose risk management requirements on NFPs that go above and beyond those imposed by other legislation that applies to them such as occupational health and safety or counter-terrorism legislation. Again, this position does not detract from the fact that the ACNC could and should play an educative role in this area.

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

As noted in the consultation paper, this approach is taken in the legislation governing Private Ancillary Funds (PAFs) but for good reason as the very purpose of such entities is to manage and distribute funds for charitable or philanthropic purposes. This does not apply across-the-board to other NFP entities, many of whom in any event have no surplus funds to invest.

In relation to non-trust organisations that do invest funds, FHF does not believe that specific requirements in relation to their management should be legislatively required. Even requiring an investment strategy would go too far as many organisations choose to simply engage professional fund managers and rely on the strategy utilised by that that manager – and this may be a reasonable approach to adopt.



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

**and**

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

This is a prime example of over-reaching. While having insurance is prudent risk management, what constitutes “appropriate” insurance can only be determined on a case-by-case basis. It should not be legislated.

The ACNC Taskforce would also be aware of the problems caused when the NSW Government required NFPs to have public liability insurance for all activities and the fact that this legislation was subsequently repealed.

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

While this section of the consultation paper commences by speaking of the value of internal reviews of procedures by which an entity operates, it then proceeds to deal only with financial reviews such as the preparation of annual accounts.

Limiting our comments similarly, FHF believes that the ACNC legislation should mirror the financial requirements imposed by other legislation by which the NFP is bound. If an entity does not have pre-existing legislative obligations, then the most that should be required by the ACNC is the lodgement of an annual unaudited financial statement which has been approved by its governing body.

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

This is a difficult question to answer. It should be noted that legislation governing some types of NFP entities already mandate certain matters that must be included in their governing rules. This is done precisely because determining the nature and scope of what mandatory rules are warranted depends on the purpose and operating environment of different classes of organisations.

FHF therefore believes that the only mandatory rule that can be legislated for inclusion in the governing rules of *all* NFP organisations is the one obligation common to them all by virtue of their non-profit nature – the requirement that their assets and income be applied solely to further the purpose or objects of the organisation and that there be no distribution of profits to members.

**22. *Should the ACNC have a role in mandating requirements of the governing rules, to protect the mission of the entity and the interests of the public?***

No. See paragraph 2 in the answer above.

Beyond this, the role of the ACNC should be to oblige responsible persons to meet the requirements of the rules that the entity has determined for itself and placed in its governing instrument.

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

The obvious answer to this may appear to be the ACNC; but there will be legal and jurisdictional difficulties in terms of it taking on this role (at least in the first instance) given the enforcement powers of other pre-existing regulatory bodies. So perhaps the sensible answer is that initially the ACNC should have referral powers to the appropriate existing enforcement agencies until such time as a cooperative regulatory scheme (including enforcement powers) is agreed and operational.

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

See above for our general answer in relation to enforcement.

In terms of wind-up or deregistration, there may be a specific role for the ACNC to ensure that the assets of the NFP are distributed to another NFP in accordance with the relevant law.

**25. *Should model rules be used?***

See our comments in Part A, Section 4.

Further to this, FHF supports the ACNC using Guidance Notes and examples to assist registered entities to understand how the final Governance Principles can be met. The ACNC should also take a proactive role in providing education and training opportunities for the sector.

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

In general, this should be left to the entity to decide in its own governing instrument. The most that should be legislatively mandated is the requirement to hold an annual general meeting at which the annual financial accounts are presented, and the obligation to hold an extraordinary meeting to alter or amend the governing instrument.

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

No. These organisations should simply be obliged to comply with the provisions of their governing instruments (for example, those relating to the convening of meetings or the provision of information to the public or other stakeholders) and with any other obligations imposed on them by other legislation.

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

See the answer in 26 above.

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

There are doubtless some classes of NFPs or some sub-sectors that could benefit from additional support, just as there are others which are already well-served (such as the international development sector with its established Code of Conduct and training strategy).

If this question is asking for guidance on where the ACNC should initially direct its support and educative services, this would best be determined through the ACNC's own advisory structure and in consultation with relevant peak bodies.

**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?**

This can really only be achieved by the establishment of an agreed cooperative regulatory framework that encompasses both federal and state/territory jurisdictions. As this will take time, the ACNC can ensure that it does not add to the compliance burden in the interim by taking a minimalist and principles-based approach to imposing any governance obligations on registered entities that go beyond those they are already legally obliged to meet.

The goal should be to establish the ACNC as the one single portal for the lodgement of all reports and information which NFPs are required to lodge, with other government bodies that continue to have a regulatory role in the future NFP regime drawing what they need from this portal.

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

We have answered this question elsewhere in this submission. In general, FHF believes that the high-level principles approach accompanied by guidance notes (as adopted by the Charities Commission of England and Wales and the New Zealand Charities Commission) is the best model.

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

FHF has no specific comment in this area.

**33. Do you have any recommendations for NFP governance reform that have not been covered through previous questions that you would like the Government to consider?**

No, but FHF would welcome the opportunity to continue to engage in the regulatory reform consultation process.

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