

Senate Economics Committee

**Inquiry into the Disclosure regimes for charities and
not-for-profit organisations**

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Introduction

The Registrar of Aboriginal and Torres Strait Islander Corporations (the Registrar) welcomes the opportunity to make a submission to the Senate Economics Committee Inquiry into the Disclosure regimes for charities and not-for-profit organisations.

The Registrar's submission addresses the inquiry's three terms of reference and discusses each one separately. The submission discusses the importance of promoting and monitoring high standards of governance and accountability in charities and not-for-profit organisations which receive significant or important funding, either private or public;¹ organisations which generate significant income; and organisations which receive tax benefits on the basis of their charity status. The submission discusses the framework provided by the *Corporations (Aboriginal and Torres Strait Islander) Act 2006* (CATSI Act) and examines contemporary practices in strong corporate governance.

The role and function of the Registrar

The Registrar is the independent statutory office holder who administers the CATSI Act. The CATSI Act replaced the *Aboriginal Councils and Associations Act 1976* (ACA Act) which was administered by the Registrar of Aboriginal Corporations.

The Office of the Registrar of Indigenous Corporations (ORIC) provides support to the Registrar in administering the CATSI Act through a range of services (see term of reference c). ORIC is an agency within the portfolio of the Commonwealth Department of Families and Housing, Community Services and Indigenous Affairs (FaHCSIA). ORIC regulates approximately 2600 Indigenous corporations, ranging in size, function and location, with 58 per cent of corporations operating in remote parts of Australia.

The key functions of the Registrar are to:

- administer the CATSI Act and maintain the register of Aboriginal and Torres Strait Islander Corporations
- regulate corporations which are registered under the CATSI Act
- monitor the legislative compliance of corporations and assisting corporations to maintain compliance
- appoint special administrators when required
- provide training for directors, members and key staff in good corporate governance
- advise individuals and groups on the registration process
- register new corporations
- assist corporations to transition from the ACA Act to the CATSI Act
- provide advice and information to corporations
- assist with the resolution of disputes within and between corporations

¹ Public funds in this context is used to describe monies invested directly by the general public, or indirectly through Australian Government funding.

The public interest in regulating high standards of corporate governance and accountability

There is a strong public interest in the Australian Government promoting and monitoring high standard disclosure regimes for charities and not-for-profit organisations.

Poor governance not only affects individual organisations, it also undermines the credibility of, and confidence in, other charities and not-for-profit organisations. It impacts the quality of services delivered and their intended outcomes and benefits to communities.

Many large and medium CATSI corporations hold significant community assets and receive funding to pursue community interests. Consequently, the CATSI Act requires such corporations to prepare audited general purpose financial statements which meet the requirements of applicable accounting standards and which are audited in accordance with the auditing standard, thus protecting community and member interests. The exception to this is that if 90% of an organisation's income is grant funding, it is permitted to submit to ORIC the financial statements that meet the requirements of its funding bodies.

The benefit of mandating high standards of governance and accountability is to provide certainty for the Australian Government, private funders, service recipients and organisation members that there are adequate governance structures in place to improve the security and delivering of the funding for services. It also reduces the risk of poor performance or illegal activity such as fraud.

Other reviews relating to this issue

The Registrar is aware that the issues of initiating reform to the not-for-profit sector, and improving the security and delivery of Australian Government funding, have been of interest to the government, funding agencies and service recipients for some time. The issues raised in this submission are also discussed and considered in a number of other reviews and papers. A particular focus has been the governance of Australian Government funded organisations and the regulatory regime they are incorporated under. Some examples are described below.

1. The Ministerial Committee for Aboriginal and Torres Strait Islander Affairs (MCATSIA) is currently undertaking a major project on governance and service delivery to Indigenous communities. Under the project MCATSIA is preparing a scoping paper on options to better regulate and support Indigenous organisations with reforms aimed at reducing the number of Indigenous organisations failing or entering administration.²
2. The Productivity Commission is about to commence a review of the contribution of the not-for-profit sector with one review aspect being to identify unnecessary burdens or impediments to the efficient and effective operation of community organisations while having regard to the need to

² MCATSIA, *Governance and Service Delivery Project Paper No. 2*, 2008, p. 7.

maintain transparency and accountability. A national compact with the not-for-profit sector is also under development.

3. The Australian government is exploring ways to develop a new and stronger relationship with the not-for-profit sector. One option being considered is a National Compact, an agreement between the Australian government and the not-for-profit sector, which could provide a framework for partnership, to work together on social inclusion priorities and broader reform within the not-for-profit sector.

Inquiry terms of reference

Term of reference (a)

Term of reference (a) seeks information regarding the relevance and appropriateness of current disclosure regimes for charities and not-for-profit organisations. The CATSI Act is a relatively high standard disclosure regime for Indigenous corporations, including charities and not-for-profit organisations. The CATSI Act, like the Commonwealth *Corporations Act 2001*, is specifically designed to ensure that it has the capacity to support and regulate corporations with significant and large income and assets. In contrast to this, the state and territory corporations legislation is intended for small non-profit organisations, not large organisations with significant assets or income.

In regulating high standards of governance and accountability, the CATSI Act incorporates two key themes:

1. Enhancing corporate transparency
2. Size appropriate disclosure obligations

1. Enhancing corporate transparency

The CATSI Act contains a number of provisions which seek to enhance the transparency and accountability of Indigenous corporations and promote best practice in corporate governance.

- The CATSI Act permits a corporation to admit observers, a class of person who can attend meetings but does not have voting or speaking rights. This enables Indigenous corporations to open their meetings to authorised external parties, without being obliged to admit these parties to participate in corporate decision-making.
- Reporting requirements for medium and large corporations are significant, consisting of a general report, an audited financial report (or non-audited financial report, depending on corporation size) and a directors' report. These requirements maximise the transparency of Indigenous corporations as perceived by the broader business sector, creditors, funding bodies and members.

2. Size appropriate disclosure obligations

The CATSI Act entails a reporting regime of graded disclosure obligations for corporations according to their size classification. Burdensome reporting requirements for small corporations are minimised, while more onerous obligations are required for medium and large corporations to maximise transparency.

- Under the CATSI Act a corporation is classified as small, medium or large according to its income, assets and number of employees. The reporting requirements of a corporation are determined according to its size classification. Small corporations with a consolidated gross operating income of less than \$100,000 are required to submit only a general report.
- The CATSI Act also aims to reduce reporting requirements for medium (and some small) corporations through the provision that a financial report which is based on reports to government funding bodies, will be accepted by ORIC in lieu of an audited financial report.
- Where Indigenous corporations form part of a larger consolidated entity the CATSI Act requires the larger entity to submit a consolidated annual report. This promotes transparency in the reporting of the larger entity.
- The CATSI Act permits the Registrar a high degree of flexibility to exempt corporations from certain record keeping, reporting and governance requirements which are considered by the Registrar to be excessive or to place an unreasonable burden on a corporation.³

Term of reference (b)

Term of reference (b) seeks information regarding models of regulation and legal forms that would improve governance and management of charities and not-for-profit organisations and cater for emerging social enterprises. This submission will outline six elements of contemporary practices in good corporate governance and accountability. The six elements derive from the Australian Stock Exchange (ASX),⁴ the Australian Sports Commission,⁵ and Rio Tinto⁶.

The rationale for aligning corporate governance standards in significant charities and not-for-profit organisations with those of publicly listed companies is based on the similar relationship held between shareholders of publicly listed companies and their directors, and members of charities and not-for-profit organisations and their boards/directors. Both members and shareholders are the 'owners' of their respective organisations and each organisation/company has a distinct legal status with special rights and obligations. Both types of organisations are managing

³ CATSI Bill (2006) *Explanatory Memorandum*, p.10.

<http://parlinfoweb.aph.gov.au/piweb/Repository/Legis/ems/Linked/16100602.pdf>. Accessed 10 July 2008.

⁴ ASX *Principles of good corporate governance and best practice recommendations*, 2007.

⁵ Sports Commission *Governance principles: A good practice guide for sporting organisations*.

⁶ Rio Tinto, *Communities standard policy*, 2007 and Rio Tinto, *Guidance for the establishment and management of trusts, funds and foundations*, 2007

public funds for a wider group and have a duty to act in the best interests of the organisation/company.

Rio Tinto is of particular interest because it is widely recognised for establishing positive and beneficial relationships with Indigenous communities. In establishing and managing trusts, funds and foundations that make payments to Indigenous organisations and communities, Rio Tinto prescribes the need to ‘establish clear standards for selection of board members and board governance’⁷ and requires independent directors to help maintain the ‘integrity and public confidence’⁸ in board decisions and the determining of funding for Indigenous programs.

Element 1: Commonwealth incorporation

The CATSI Act and the *Corporations Act 2001* provide for a robust and structured framework for the operation of organisations. The Commonwealth legislation is comprehensive and provides clarity in areas otherwise silent within the state and territory associations incorporation legislation.⁹

In promoting accountability and providing greater security to Australian Government funding, the Commonwealth legislation entails:

- Regulatory powers to examine the operation of corporations, inspect corporation’s books and if necessary place corporations under administration
- Reporting and disclosure requirements
- Support services (for Indigenous corporations registered under the CATSI Act).

Commonwealth incorporation also minimises barriers to the commercial growth of corporations by facilitating national commercial development and minimising the impediments associated with state and territory legislative frameworks.

Element 2: Board composition, roles and powers

As outlined by the ASX, ‘an effective board is one that facilitates the effective discharge of the duties imposed by law on the directors and adds value in a way that is appropriate to the particular company’s circumstances.’¹⁰

This element proposes that the roles and responsibilities of the board and management are set out in the constitution of the organisation with clear accountability to the members or shareholders. Members elect the majority of the board.

A clear distinction is drawn at all times between the roles of the CEO and the chairperson and that the same person does not perform both roles. The CEO is not a director of the board. The board undertakes a documented performance review of the CEO.

⁷ Rio Tinto, *Communities standard policy*, 2007, p. 4.

⁸ Rio Tinto, *Guidance for the establishment and management of trusts, funds and foundations*, 2007.

⁹ ASC, *Governance principles: a good guide for sporting organisations*, pp. 3–4.

¹⁰ ASX *Principles of good corporate governance and best practice recommendations*, 2007, p. 16.

The size of an organisation's board is stated in the organisation's constitution and is structured so that it has a proper understanding of and competence to deal with current and emerging issues of the organisation, and can effectively review and challenge the performance of management and exercise independent judgement.

An organisation's board has between five and 12 members. The CATSI Act prescribes that an Indigenous corporation must not have more than 12 directors: s. 243-5 and the Australian Sports Commission guidelines recommend between five and nine directors. However, under the CATSI Act Indigenous corporations can be exempted from this provision in particular circumstances, such as directors representing families with more than 12 families being represented, s. 310-5(2)(a).

The CATSI Act contains a range of measures which facilitate the development of Indigenous corporations by delivering maximum flexibility in corporate design. This aligns with international observations that corporate governance is enhanced when groups are permitted to select corporate design arrangements which best facilitate their needs.¹¹ The CATSI Act includes a framework of replaceable rules which enables groups to simultaneously tailor their corporate structure and meet the requirements of the Act.

The CATSI Act enables the registration of small enterprises by allowing a corporation to have less than five directors, including single directors, in circumstances considered appropriate and reasonable by the Registrar.

The CATSI Act also allows Indigenous corporations to make a choice as to whether to allow non-Indigenous directors, so long as a majority of Indigenous directors is maintained. This provides flexibility in terms of corporate structure and delegates decision making power regarding corporate structure to Indigenous groups. In the case of appointing directors, this provision enables Indigenous corporations to utilise the skills and expertise of a director, for example lawyers, accountants and doctors, to discharge their directors' duties and to fulfil their obligations.

¹¹ A Modern Statute for Indigenous Corporations: Reforming the *Aboriginal Councils & Associations Act 1976* (Cth). Final report of the Review of the *Aboriginal Councils & Associations Act 1976* (Cth). December 2002. By Corrs Chambers Westgarth with Anthropos Consulting, Mick Dodson, Christos Matziaris, Senatore Brennan Rashid. Page 58. Report commissioned by the Office of the Registrar of Aboriginal Corporations.

Element 3: Independent directors

The Registrar is familiar with the growing recognition of independent directors as a key element of strong corporate governance. The ASX guidelines recommend that the majority of directors be independent. The Australian Sports Commission recommends that 100 per cent of directors of organisations it funds should be independent. A summary of some proposed models for independent directors is set out in Table 1 below.

Table 1 Existing models for independent directors

	ASX guidelines ¹²	Rio Tinto guidelines ¹³	Australian Sports Commission ¹⁴
Independent directors	Yes	Yes	Yes
Mandatory or recommended	Recommended but 'If not, why not approach' ¹⁵	Recommended for native title trusts (usual practice)	Strongly recommended
Number of independent directors	Majority of directors	Varies according to circumstances	100% of directors (5-9 directors)
Appointed by election or appointment	Election by shareholders	Appointed by consultation between Rio Tinto and community	Election by members or appointed by board of directors

What is independence? There are well established legal and practical definitions of independence. In summary, an independent director is defined as a director without existing or past relationships with an [organisation] that might materially interfere with his or her ability to work in the best interests of the [organisation].¹⁶ Independent directors are those that are not appointed to represent a constituent body, are not employed by or have a significant business relationship with the organisation, do not hold any material office within the organisational structure and have no material conflict of interest as a result of being appointed director.¹⁷

Remunerating independent directors: The generally preferred approach is to source volunteers with appropriate skills to act as independent directors for organisations. However, this will not always be possible, particularly in remote and regional Australia and some remuneration may need to be paid to people to act as independent directors, particularly those with the right skill set.

¹² ASX Corporate Governance Council, *Principles of good corporate governance and best practice recommendations* (guidelines), 2007

¹³ Rio Tinto, Communities standard policy, 2007 and Rio Tinto, *Guidance for the establishment and management of trusts, funds and foundations*, 2007

¹⁴ ASC, *Governance principles: a good guide for sporting organisations*, p. 3-4.

¹⁵ ASX listed corporations must either comply with the recommendations or explain their reasons for non-compliance in their annual reporting: the 'if not, why not' approach.

¹⁶ ASX Corporate Governance Council, *Principles of good corporate governance and best practice recommendations* (guidelines), 2007, p. 16.

¹⁷ ASC *Governance principles: A good guide for sporting organisations*, p. 6-7.

The payment of remuneration to independent directors could affect the non-profit taxation status of an organisation. Further clarification is required and reimbursement of expenses is not affected.

It is proposed that if an independent director is remunerated the amount should, for reasons of equality and fairness amongst directors, be consistent with any remuneration paid to non-independent directors. As the appointment of independent directors will provide greater security for funding agencies it is recommended that nominal sitting fees for independent directors be incorporated into funding provided by the Australian Government.

Sourcing independent directors: A large pool of appropriately qualified people to act as independent directors would be required. To support organisations in securing independent directors it is proposed that organisations such as Indigenous Community Volunteers, the Business Council of Australia, the Australian Institute of Management and the Australian Institute of Company Directors be approached for assistance. Corporate Australia is actively examining ways as part of its corporate social responsibility obligations to support communities and community organisations.

In remote or regional areas, it may be difficult for Indigenous corporations to source sufficient independent Indigenous directors because of close family or other relational connections. In such circumstances it would be difficult to impose a requirement for a majority of independent directors. A majority requirement may also be too onerous for some community organisations.

In considering this element, it will be pertinent to consider the percentage of independent directors which would be required, which organisations the new rules would apply to, the timeline by which new obligations would have to be met, and what transitional arrangements would be necessary.

Element 4: Board processes and governance

This element proposes that the board of an organisation has documented policies and processes regarding board and member/shareholder meetings (agendas, preparation and distribution of board papers, regular financial reports, minutes, meeting frequency) as well as current strategic and costed business plans for the organisation. The board would also have a code of conduct or policy setting out the behaviour expected of directors.

Element 5: Director support

It is recommended that the board should have access to independent professional advice if required. It is also proposed that an organisation should ensure that its directors and staff have appropriate insurance cover. To attract quality independent directors the organisation has adequate liability and indemnity protection in place: directors and officers insurance.

Element 6: Relationship with members/shareholders

This element proposes that a board of directors should act in the best interests of the organisation as a whole and its constitution should provide transparency, accountability and responsibility to its members. The members should have the power in the organisation's constitution to remove directors. If an independent director is removed, another independent director should replace the person.

Directors who are members should not vote at members' meetings on issues in relation to which they have a potential conflict of interest.

An annual general meeting of members should be held at least once per year. It is proposed that the board should provide, at the annual general meeting, a comprehensive annual report containing:

- any information legally required under the organisation's incorporating legislation
- governance of the organisation, including board members and key management personnel
- financial reports (audited, if required by legislation or the funding agreement)
- the organisation's achievements and strategic goals and objectives
- material foreseeable risks for the organisation
- report against the operational and strategic plan of the organisation.

Any major or material change in business or significant acquisition or disposal of assets should be disclosed to the members before the organisation finalises the transaction, subject to commercial confidentiality.

Term of reference (c)

Term of reference (c) seeks information regarding other measures that can be taken by government and the not-for-profit sector to assist the sector to improve governance, standards, accountability and transparency in its use of public and government funds. As a special measure, the CATSI Act delivers, through ORIC, a range of services to Indigenous corporations, which assist in improving corporate governance and the operation of Indigenous corporations. These include:

ORIC corporate governance training and capacity development program

A range of training services tailored to individuals and to corporations, are delivered through the ORIC training program. They include:

- Regional workshops to assist corporations to transition to the CATSI Act
- Non-accredited governance workshops tailored to regional and remote Australia
- Nationally accredited Certificate IV in Business (Governance) and the Diploma of Business (Governance)

- Post administration training, facilitated with individual corporations prior to the end of an administration

The latest Productivity Commission Report on *Overcoming Indigenous Disadvantage: Key Indicators 2007* identified ORIC's training program, and ORIC's training partnership with the Victorian state government and Swinburne University, as being 'things that work' in increasing governance capacity and skills in directors and key staff in Indigenous corporations.¹⁸

ORIC advice, information and support

ORIC provides advice, information and support to Indigenous corporations, prior to and following registration, in relation to the registration process and corporate issues. This service is strongly utilised by corporations, some of which are likely to have had minimal corporate governance experience. ORIC's 'doorway service' helps Indigenous corporations before they are setup and ensures they are appropriately structured and aware of their requirements under CATSI legislation on registration.

ORIC dispute resolution and mediation

ORIC has recently taken on a role of dispute resolution and mediation between members of a corporation and between different corporations. Conflict between family and interest groups is a characteristic of some Indigenous corporations and has been a key factor contributing to a perception in the broader business sector, that Indigenous corporations are unstable and should therefore not be engaged with on a commercial basis. The decision by the Registrar to provide dispute resolution and mediation services to corporations makes a direct contribution to addressing this issue.

ORIC examinations

The CATSI Act permits the Registrar to authorise an examination of the books of an Indigenous corporation. ORIC implements an ongoing program of examinations, which is both rolling and reactive. Rolling examinations are those undertaken as a safeguard measure in regions across Australia, with a particular focus on corporations with large income and assets. Reactive examinations are undertaken in response to a corporation coming to the attention of the Registrar. The power granted to the Registrar by the Act to authorise examinations, and the associated program which is implemented by ORIC, increase the likelihood that operational or procedural problems within a corporation will be detected in the early stages.

The examinations program also enhances the transparency of corporations. These outcomes provide grounds for increased confidence on the part of funding bodies and the broader business sector, that Indigenous corporations are relatively secure entities in which to invest resources.

¹⁸ Productivity Commission Report on *Overcoming Indigenous Disadvantage: Key Indicators 2007*, p. 646.

Appointment of special administrators

The CATSI Act grants the power to the Registrar to place a corporation under special administration and appoint a special administrator. A special administrator is an external administrator with the power to manage all or some of the affairs of a corporation. In practical terms this almost always will be all of the corporation's affairs. Part of the work done during the special administration is to build the corporate governance capacity amongst the members which in turn promotes the long term sustainability of the corporation. The appointment of special administrators is taken in extreme cases of non-compliance when the appropriate grounds have been established. Appointing special administrators provides certainty to funding bodies and the broader business sector that resources and investments are secure while the appointment is in place.

Prosecutions

Under the CATSI Act the Registrar has the power to investigate alleged corporate offences, to identify cases that are appropriate for referral as a prosecution, and to refer these matters to the appropriate prosecution agency. These investigation and referral powers enable the Registrar to respond when alleged corporate offences come to light, further increasing the transparency and security of Indigenous corporations for funding bodies and the broader business sector.