Due Diligence Checklist for new Directors of not-for-profit boards

Before becoming a director of a not-for-profit board, you should do your homework. You should understand what the organisation is about, and whether or not you will be able to work with the organisation.

We have included a list of useful matters to consider to assist you in obtaining a good understanding of the organisation before you take your seat at the board table.

**STEP 1: Establish the organisation’s legal and reputational status**

- Establish what kind of legal entity the organisation is:
  - If the organisation is a public company limited by guarantee, you will have to comply with the Corporations Act 2001 (Cth).
  - If the organisation is an incorporated association, you will have to comply with the associations legislation in your State or Territory (i.e. Associations Incorporation Act 2009 (NSW)).
  - If the organisation is a trust or other entity, your legal obligations will be different again.

- Is the organisation a registered charity? Check the Australian Charities and Not-for-Profit Commission Register (www.acnc.gov.au) to confirm. The website has useful information to help you understand the obligations of charities.

- Ask the current board if there have been any legal claims against the organisation in the last three years or any outstanding or pending claims that may result in board liability.

- Try to understand what the organisation’s reputation is in the community. Use Google.

- Is the organisation affiliated with any other organisation? What is the legal relationship between the organisations?

**STEP 2: Review the relevant documents**

Request copies of all relevant documents. The organisation may not have all of these documents, but if they exist, you should review them:

- The governing document (including all amendments);
- The current by-laws (if any);
- A list of current directors and officers (including the CEO), indicating when their terms expire;
- A list or chart of staff positions and duties, with the salaries of the highest paid members;
- A list of board committees and advisory committees;
- The two most recent audited financial statements and any subsequent financial statements or reports;
- Any policy documents or mission statements that are not part of the by-laws;
- The organisation’s website and any printed literature that is regularly handed out to donors or clients of the organisation;
- Conflict of interest policies for board members and officers and
- Any director liability insurance policy and a summary of other insurance coverage for the organisation.

**STEP 3: Pay particular attention to the governing document**

- The governing document is usually, but not always, called the constitution.
- The governing document constitutes a contract between you and the organisation and its members. You should read it carefully as you will be bound by its terms.
- Ask when the last time was that the governing document was reviewed. We recommend that governing documents be reviewed at least every 2-3 years to ensure consistency with the law, good governance, best practice and to ensure that the document is still relevant for the organisation.
- Some of the most important parts of the constitution for you to review are:
  - (i) The board or committee section:
    - This section will explain the process for appointing or electing you to the board, what your term of office will be, how many times you could be re-appointed or elected and how you could be removed from office. The constitution may also set out what officer-bearer positions there are on the board.
  - (ii) The objects section:
    - This section is the organisation’s mandate to operate. The organisation cannot do anything which is inconsistent with the objects.
  - (iii) The directors’ remuneration clause:
    - As a not-for-profit organisation, directors cannot receive a share of the profits of the organisation. Some not-for-profits do, however, pay directors sitting fees and fees for services performed outside the scope of their role as director.
  - (iv) The indemnities clause:
    - This clause sets out the extent of any indemnities offered to directors of the organisation. You should check that you are happy with the level of protection you will receive.
- Is the organisation paying indemnity insurance? Will that protection extend beyond your term of office?

**STEP 4: Ask questions**

The board

- Are there separate governance policies? If so, request a copy and review them. The governance policies may set out your role and responsibilities.
- Ask the current board:
  - Who are the current board members and how long has
each of them held office?

(iv) If it is not set out in the constitution, what will be your term of office and can you be re-appointed or re-elected to the board?

(v) What is the size of cover for the directors’ liability insurance?

(vi) Is the CEO a board member?

(vii) Is there a clearly defined policy or CEO instrument or delegation prescribing the board’s delegation to the CEO?

(viii) Are there any separate codes of conduct or ethical practice?

(ix) What committees have the authority to act on behalf of the board between board meetings? What committees are purely advisory? How are committees elected or appointed?

(x) Does the organisation offer each director a deed of indemnity and access?

(xi) Ask discreetly about any excessive politics which are played at board level. Is it the case that one or two of the directors (or even a powerful figure who is not, actually on the board) exercises excessive control over the dynamics and decision making of the board?

(xii) How are officers appointed? Is the actual practice consistent with policies or by-laws? What arrangements are in place with the highest paid employees? What are their salaries and how long are their contracts for?

(xiii) Does the organisation have a risk management policy?

Expectations of you

Ask the current board:

☐ About board meetings:
   (i) How often are board meetings held, how long do they run for and what is the attendance rate like at board meetings?
   (ii) Who prepares the agenda and are board papers and reports always sent to directors at least a week in advance of board meetings?
   (iii) What is the focus of board meetings generally? For example, board meetings may focus on policy development, operational decision-making, financial assessment, operational monitoring or strategic discussions.

☐ Are there any board committees? And will you be expected to sit on them?

☐ Will you be an ex officio member?

☐ Will expenses be reimbursed?

☐ Are there any policies outside of the constitution for removing directors for non-performance?

☐ How much will you be paid, if anything?

☐ What induction and ongoing training is provided to board members?

☐ Is there a director’s manual or resource to assist the director in understanding the role and familiarising oneself with the organisation?

The strategic direction of the organisation

Find out answers to the following questions from the documents or from asking the board:

☐ Does the organisation have a strategic plan? When was it last reviewed? Does it reflect the actual practice of the organisation? Have strategic goals been met in the last two years?

☐ How is strategic performance reported to the board?

☐ How is the CEO’s performance measured?

☐ What are the current CEO’s qualifications and experience and how long has the CEO held the position?

☐ How involved is the board in other operational matters such as appointment of staff, internal dispute resolution, work and health and safety?

STEP 5: Familiarise yourself with the finances

Find out answers to the following questions from the documents or from asking the board:

☐ What is the organisation’s tax status?

☐ How are financial matters reported to the board?

☐ What are the organisation’s sources of funds?

☐ What has the organisation’s cash position been like over the previous year?

☐ Are you confident, from your review of the financial reports, that the organisation can meet its debts and liabilities? If you are not certain, ask.

☐ Are long-term borrowings, e.g. mortgages over buildings, adequately secured?

☐ Is there an audit committee? Who is the auditor and how long has that person been the auditor? Do the last two audited financial reports include any concerns from auditors?

☐ Does the organisation have an independent external financial advisor?

☐ Are there financial policies and systems in key areas such as financial reporting, CEO and officer remuneration, financial management and protection of assets?

☐ What are the organisation’s significant assets and what are their values?

☐ Does the organisation have a policy to protect its assets?

☐ How often does the board review financial reports and policies?

☐ Does the organisation have an investments policy? Are investments secured? Does the organisation have an overdraft arrangement with a bank? Is that facility utilised often?

☐ Who has authority to sign cheques on behalf of the organisation? Who has authority to purchase major capital items?

STEP 6: Clarify anything that doesn’t seem right

☐ After reviewing the documents and making the queries above, if there is anything that doesn’t seem right to you, ask more questions. For example:

(a) Do you see anything on the website, the financial statements, the tax returns, or elsewhere that raises issues around potential conflicts of interest between any board members and the organisation?

(b) Do you see anything else on the website or in operations that may be inconsistent with the organisation’s tax-exempt status?

☐ Importantly, would you support the objects from the organisation constitution and can you dedicate the time required to attend meetings and remain up-to-date and knowledgeable about the finances of the organisation?

After reviewing the documents and making enquiries, if there is anything that doesn’t seem right to you, ask questions.
Introduction

Your constituent document, which you would know as either your constitution or rules (which we will refer to in this checklist as the constitution), is the document that governs how your organisation operates. It is a legal document and its terms must be complied with at all times. Regardless of whether your organisation is a company or an incorporated association, there will be provisions in your constitution that are statutorily required under the relevant legislation (ie the Corporations Act 2001 (Cth) or the Associations Incorporation Act of your state).

With the ebb and flow of time it is common for organisations to depart from their originally determined path, and this often results in the objects, activities and operations practised by the organisation being out of sync with those stated in its constitution. We have set out below those areas that are most susceptible to variation, and to which particular attention should be paid during any review.

How often should you review your constitution/rules?

Like any long-term set of rules, your constitution should be reviewed from time to time (we suggest every two to three years) to ensure that:

- it reflects your current objects, activities and operations;
- it does not risk any tax endorsements or concessions that you may currently enjoy;
- you have incorporated any changes to the legislation since the last review;
- your processes continue to be workable and flexible enough to meet your practical needs; and
- your organisation is compliant with the new law.

Review required?

A. Objects

1. Ensure the objects - as drafted in the constitution - still reflect the objects and activities of the organisation.

   It is vital that this clause accurately reflects at all times:
   a) what the organisation is doing; and
   b) the purpose of the organisation.
   Special care must be given to ensure that the organisation satisfies the ATO criteria to enable the organisation to be eligible for appropriate tax endorsements and concessions.

B. Board/Committee

2. Appointment/election of directors/committee members
   - How are directors/committee members appointed/elected?
   - Is the procedure stated in the constitution still being applied?
   - Do you require any changes to the procedure? Is the procedure consistent with your relevant Act?
   - Consider whether independent directors/committee members can be appointed/elected. You may wish to alter how the board/committee is constituted eg the appointment of specially qualified directors/committee members.
   - Are you satisfied with the size of the board/committee?
   - Are directors/committee members required to be members of the organisation? If so, will those members be able to bring the range of perspectives necessary to ensure robust decision making?

3. Office bearers
   - Which office bearers do you wish to have on your board/committee? For example, president, chair, vice president, treasurer etc.
   - How are office bearers elected/appointed?
   - What is the length of their term of office?
   - Do you have office bearers required by your relevant Act?
   - Do you need all of the office bearers?
   - Is the statutory role of secretary/public officer appointed in accordance with the relevant Act?

4. Term
   - What is the term of the directors/committee members and is this still appropriate?
   - How many maximum number of consecutive terms can a director/committee member hold office for? Do you want to change this?
   - Do all directors/committee members come up for election in the same year? If so, has consideration been given to the implications of all being changed at once?

5. Board/committee meetings
   - The procedural aspects of convening board/committee meetings should be reviewed eg what is the required notice period, and whether this would allow directors/committee members to meet their care and diligence obligations in all circumstances?
   - How is the chair appointed and does the chair have a casting vote?
   - Can the directors/committee members change the chair if the chair proves to be ineffective?
   - Is the chair the President (or effective head irrespective of the title)? If not, do the different roles cause inappropriate pressures that should be corrected?

6. Expulsion of directors/committee members
   - Check the circumstances for expulsion of a director/committee member. Does it:
     a) comply with the law; and
     b) allow for natural justice and due process?
   - Does the wording of any particular circumstance inadvertently result in the directors effectively removing a director in contravention of the Act?
7. **Vacancies**
   How are vacancies dealt with in the constitution? Does the procedure work in practice?

8. **Alternate directors/committee members**
   - Can alternate directors/committee members be appointed and is board/committee approval required?
   - Do you want alternates with the complications they bring?
   - If you need alternates, is an agreed pool a better option than individual alternates?

9. **Delegated authority**
   Over time it may have become convenient for the board/committee to establish subcommittees to assist with certain aspects of the organisation’s governance. This is an important clause and you should ensure that it is included in the constitution. You need to consider:
   - the procedure for their establishment;
   - how they are to be constituted;
   - a process for their routine/regular review to ensure they remain relevant; and
   - how they are to operate.

10. **Remuneration**
    - Are directors/committee members remunerated for their roles as directors/committee members of the organisation and, if so, does this comply with the law?
    - Does the constitution provide for directors/committee members to receive payment for services provided to the organisation by that director/committee member? If so, are there checks to ensure the facility is not exploited?

C. **Indemnities**
   11. Ensure that indemnity and insurance clauses are contained in the constitution and that they provide adequate protection for the officers of the organisation. How broadly/narrowly do you want to extend this coverage? It is important to seek legal advice in respect of these provisions, particularly if they have not been reviewed or updated for some time.

D. **Members**
   12. Does the organisation have different classes of membership?
       If so, has there been any variation to the organisation’s membership classes?
       If not, consider whether the introduction of different classes of membership would be beneficial to the organisation’s structure and finances.
       If so, are they different classes or just categories of the same class?
       If so, are class rights effectively addressed?
   13. Check the eligibility criteria for admission as a member.
       If the organisation has deviated from its initial objects, it is worth considering whether the membership criteria require amendment. For example, would the requirement for particular qualifications be beneficial?
   14. Do the eligibility criteria for membership contravene the Competition and Consumer Act 2010 (Cth), and do any of the Objects risk contravening the same Act? Does the power to set fees reside with the directors/committee members who have a fiduciary duty or with the members who have no fiduciary duty?
   15. If you have corporate members, is there a “Representative” clause in the constitution?
   16. Does the organisation follow the dispute resolution procedure as set out in the constitution? The dispute resolution procedure should also be reviewed to ensure that it complies with the relevant legislation.
       This applies to disputes between members and disputes between members and the organisation.

E. **Members’ meetings**
   17. The legal requirements and procedures at members’ meetings may have changed and it is important that your constitution accurately records what is legally required of such meetings.
   18. If your constitution has not been reviewed for some time, it may not include a clause allowing the latest technology to be used to conduct members’ meetings. For convenience, this should be included.
   19. Does the chair have a casting vote at members’ meetings?
   20. For companies still with inappropriate restrictions, have you yet changed to allow the appropriate appointment of proxies?
   21. Does the quorum requirement remain practicable?
   22. Have you considered allowing for direct voting?

F. **Winding up**
   23. Ensure that the winding up provisions comply with the legislation and with ATO requirements for eligibility for tax endorsements and concessions. Otherwise, your organisation may risk losing its tax endorsements/concessions.
   24. Are the winding up processes practicable? Do you have a fall back if a meeting of members cannot be held?
1. Are you a registered charity?

Yes: Are you a registered charity?

Yes: All income Tax-Exempt Funds need to be endorsed by the ATO to receive the tax concession. ACFI can then be registered as a charity. All registered charities which are endorsed by the ATO do not have to pay income tax. (Don’t know? Go to www.ato.gov.au and see if your energy is listed on the endorsed list.)

No: You are a registered charity.

2. Are you a Not-For-Profit (NFP) entity?

Yes: You are a Not-For-Profit (NFP) entity. To do Not-For-Profit tax, proceed to question 3.

No: You are not a Not-For-Profit (NFP) entity. Proceed to question 4.

3. Are your income Tax-Exempt Funds?

Yes: All income Tax-Exempt Funds need to be endorsed by the ATO to receive the tax concession. ACFI can then be registered as a charity. All registered charities which are endorsed by the ATO do not have to pay income tax. (Don’t know? Go to www.ato.gov.au and see if your energy is listed on the endorsed list.)

No: You are not a Not-For-Profit (NFP) entity. Proceed to question 4.

4. Do you fall into one of the categories of Tax-Exempt Funds?

Yes: All income Tax-Exempt Funds need to be endorsed by the ATO to receive the tax concession. ACFI can then be registered as a charity. All registered charities which are endorsed by the ATO do not have to pay income tax. (Don’t know? Go to www.ato.gov.au and see if your energy is listed on the endorsed list.)

No: You are not a Not-For-Profit (NFP) entity. Proceed to question 4.

5. Are you a registered charity?

Yes: All income Tax-Exempt Funds need to be endorsed by the ATO to receive the tax concession. ACFI can then be registered as a charity. All registered charities which are endorsed by the ATO do not have to pay income tax. (Don’t know? Go to www.ato.gov.au and see if your energy is listed on the endorsed list.)

No: You are not a registered charity. Proceed to question 4.

6. Is your organization a Not-For-Profit (NFP) entity?

Yes: All income Tax-Exempt Funds need to be endorsed by the ATO to receive the tax concession. ACFI can then be registered as a charity. All registered charities which are endorsed by the ATO do not have to pay income tax. (Don’t know? Go to www.ato.gov.au and see if your energy is listed on the endorsed list.)

No: You are not a Not-For-Profit (NFP) entity. Proceed to question 4.

7. Are you a registered charity?

Yes: All income Tax-Exempt Funds need to be endorsed by the ATO to receive the tax concession. ACFI can then be registered as a charity. All registered charities which are endorsed by the ATO do not have to pay income tax. (Don’t know? Go to www.ato.gov.au and see if your energy is listed on the endorsed list.)

No: You are not a registered charity. Proceed to question 4.

8. Is your organization a Not-For-Profit (NFP) entity?

Yes: All income Tax-Exempt Funds need to be endorsed by the ATO to receive the tax concession. ACFI can then be registered as a charity. All registered charities which are endorsed by the ATO do not have to pay income tax. (Don’t know? Go to www.ato.gov.au and see if your energy is listed on the endorsed list.)

No: You are not a Not-For-Profit (NFP) entity. Proceed to question 4.