

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

Mills Oakley Not-for-Profit and Social Enterprise

**MILLS
OAKLEY**

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 assisting 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 association's 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-Profits 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 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 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 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:*
 - **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 re-elected and how you could be removed from office. The constitution may also set out what office-bearer positions there are on the board.
 - **The objects section.**

This section is the organisation's mandate to operate. The organisation cannot do anything which is inconsistent with the objects.
 - **The director's 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.
 - **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?*
- *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?*
- *What is the size of cover for the directors' liability insurance?*
- *Is the CEO a board member?*
- *Is there a clearly defined policy or CEO instrument of delegation prescribing the board's delegation to the CEO?*
- *Are there any separate codes of conduct or ethical practice?*
- *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?*
- *Does the organisation offer each director a deed of indemnity and access?*

- Ask discretely 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?
- 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?
- Does the organisation have a risk management policy?

Expectations of you

- Ask the current board about board meetings:
 - How often are board meetings held, how long do they run for and what is the attendance rate like at board meetings?
 - Who prepares the agenda and are board papers and reports always sent to directors at least a week in advance of board meetings?
 - 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 office-bearer?
- What expenses will 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 directors' 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 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 enquiries above, if there is anything that doesn't seem right to you, ask more questions. For example:

- 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?
- 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 objects from the organisation constitution and can you dedicate the time required to attend meeting 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.

