



Mergers and Acquisitions A Guide for the Not for Profit Board

JFMLAW
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The Basics

This guide helps not for profit organisations to get a handle on the basic information and principles that should be understood whenever a formal relationship is put in place between two or more not for profit organisations. By 'formal relationship', we mean the various legal structures that can be put in place by organisations who want to work together to provide services to clients.

Understanding your own organisation

No organisation should think about exploring formal relationships with other organisations without first having a clear picture of their own circumstances. The board should be able to identify precisely why it wants to put a formal relationship in place and how that formal relationship will benefit the organisation as a whole.

Equally, it is necessary for the board to have an understanding of the nature, values, culture, legal structure and tax status of their own organisation before determining IN

Key question

Can you express your organisation's values in ten words?

Why should not for profit organisations strike up a formal relationship?

Not for profit organisations should explore working together in a formal relationship if the respective boards are satisfied that the organisations could better pursue their strategic plan and better further their objects or purposes by putting in place a formal relationship with another organisation.

There are a number of circumstances in which this may be the case. Organisations can better provide services to their clients when they share resources, skills and experience. Sometimes, merging two organisations or working together on a specific project can attract improved public funding. It may allow organisations to improve their community engagement and reach a wider range of potential clients.

Key question

How does a formal relationship fit within your strategic plan?

How should a not for profit organisation determine which organisations are appropriate partners?

It is imperative that the board of each organisation determines that the organisations are a good fit for each other before exploring the possibility of putting a formal relationship in place. Specifically, the respective boards should be satisfied that:

- a. they understand the values and culture of the other organisation;
- b. the values and culture of the other organisation are compatible with those of their own organisation;
- c. they understand the vision that the other organisation has for the relationship between the two organisations; and
- d. that vision is compatible with their own vision for the relationship.

At the very outset, it is a good idea for the board to ask representatives of the other organisation the following questions:

- (a) what are the values of your organisation?
- (b) what are the major strengths and weaknesses of your organisations?
- (c) what are the major risks and opportunities for your organisation over the short, medium and long term?
- (d) how does your organisation recruit talented people for the board and the executive team?
- (e) how does the Board engage with the Chief Executive Officer?
- (f) do you have tax-exempt status?
- (g) do you have deductible gift recipient status?
- (h) what is your legal structure?

Key question

Do the organisations have compatible values and visions?

What sorts of formal relationship can not for profit organisations have?

There are a number of legal arrangements which allow for not for profit organisations to work with each other to achieve a common goal. These include:

- (a) memoranda of understanding;
- (b) joint ventures;
- (c) mergers and takeovers;
- (d) amalgamations; and

(d) auspicing. It is important for not for profit organisations to select the most appropriate form of legal arrangement for their specific needs. Each arrangement is distinct, and carries with it different obligations and liabilities. Some arrangements may have negative implications for tax exemptions. Please get in touch with Dominic Cudmore at our office if you have any questions in this regard.

Whichever form of relationship is preferred, it is best if the relationship is formalised through a written document that details the legal structure that has been selected. This will ensure that the relationship is placed on a clear and certain footing. This is particularly important when things go wrong and disputes arise.

Key question

**Which form of relationship best achieves
our strategic plan?**

Selecting the Appropriate Legal Arrangement

Establishing a sub-committee

As there are a number of arrangements which can be put in place to formalise a relationship between two not for profit organisations, it is a good idea for the board to establish a sub-committee to report to the board on which legal structure would be most suitable for the organisation. This sub-committee should be comprised of the Chair, the Public Officer, the Chief Executive Officer and the Treasurer. The sub-committee should be delegated the authority to engage external legal and accounting advice.

A reminder

Make sure the terms of reference of the sub-committee give it an indication of the reasons why a formal arrangement is being explored.

What is a memorandum of understanding?

A memorandum of understanding is an informal document not generally intended to bind the parties, but may be used to form the basis of a relationship between two organisations. They may specify that the organisations will co-operate or collaborate with each other in certain areas or share certain information.

For example, two charities that help out disabled people might sign a memorandum of understanding to set out their respective obligations for planning and running a family fun day.

When is it appropriate to enter into a memorandum of understanding?

A memorandum of understanding offers the benefit of allowing two organisations to put their relationship on a certain footing without necessarily incurring legal

obligations to one another. They are good for making sure that everything that has been agreed by the organisations is recorded formally in writing.

It is also worth noting that a memorandum of understanding may be appropriate if two organisations wish to commence negotiations for an amalgamation, a merger or a joint venture. It can help to clarify the parameters of the subsequent negotiations, and the goals or aims that the organisations wish to achieve by putting in place a more formal relationship.

A reminder

It is a good idea for a memorandum of understanding to include a clause stating that the parties do not intend to be legally bound by it.

What is a joint venture?

A joint venture is a formal contractual relationship between two organisations in which they each agree to contribute resources for the purposes of a particular project or undertaking. Joint ventures may take a variety of forms. For example, it may involve the two organisations setting up a separate organisation or trust through which to conduct the venture.

It is important to note that joint ventures may impose fiduciary obligations on organisations that enter them, even if such obligations are not contained in the contract. These include an obligation for organisations to avoid conflicts of interest and to avoid making individual gains from their position as a party to the joint venture. Whether fiduciary obligations arise will depend on the nature of the joint venture entered into, the circumstances in which it was entered into, and the particular terms of the contract that forms its basis.

For example, an organisation that assist victims of domestic abuse may sign a joint venture agreement with a children's charity to set up a crisis shelter for victims of family violence.

When is it appropriate to enter into a joint venture?

A joint venture is of a more limited scope than mergers and amalgamations. It may be appropriate where two organisations wish to work together on a particular project or for a particular project. It does not require the organisations to join together to form a single organisation.

An important consideration militating in favour of joint venture agreements is that they are a very flexible form of legal arrangement. This flexibility allows organisations to ensure that the terms of the joint venture agreement reflect their particular goals and circumstances.

Key question

What liabilities and responsibilities is your organisation prepared to take on? Are these reflected in the terms of the agreement?

What are mergers and takeovers?

Mergers and takeovers are not strictly relationships between two not for profit organisations. Rather, they are a process by which two organisations join together to become a single organisation.

In a merger, two organisations come together to form a new organisation. In these circumstances, the assets, liabilities, business and staff of both organisations will be taken over by a new organisation, and the two merging organisations will cease to exist.

In a takeover, one organisation acquires or buys another organisation. In these cases, one organisation will take over the assets, liabilities, business and staff of another organisation. The other organisation will then cease to exist.

For example, two charities who both work with stray animals in the inner suburbs of Sydney might merge to create a bigger organisation that can employ more people, lease better premises, and get more funding.

When is it appropriate for an organisation to merge or organise a takeover?

One of the primary motivations for a merger is the pursuit of economies of scale. In the not for profit space, this refers to the fact that a single organisation with more resources may be able to operate more efficiently than two smaller organisations working in isolation. This can reduce costs for the organisation and, ultimately, for its clients.

There are a number of important questions which should be answered by the board whenever a merger or takeover is on the table. Aside from determining that the organisations are compatible on the basis of the considerations outlined above, the board should consider:

- a) whether the legal structure and tax exemption status of the two organisations is identical or compatible;
- b) whether members of one of the merging organisations will outnumber members of the other merging organisation once the new organisation is formed;
- c) whether the senior staff members employed by the organisation will be taken over to the new organisation, or whether the merger will involve a redundancy;
- d) whether the new organisation will have one large board comprised of the board of both organisations, or whether a new board will be elected.

Key question

Will the merger or takeover have negative implications for existing tax exemptions?

What is an amalgamation?

An amalgamation is very similar to a merger in which two organisations come together to form a new organisation. It only applies to incorporated associations operating in the same State.

A reminder

Amalgamation is only available to incorporated associations.

When is it appropriate for organisations to amalgamate?

Amalgamation may be an attractive option for incorporated associations for the same reasons that mergers are attractive for other organisations.

What is auspicing?

Auspicing is a process by which an incorporated not for profit organisation takes an unincorporated not for profit organisation under its wing for a specific project that the unincorporated organisation wishes to undertake. While each auspicing agreement will differ, it is generally the case that the incorporated organisation will agree to receive funding for the project on behalf of the unincorporated organisation, and will cover the activities of the unincorporated organisation relating to the project under its insurance policy.

For example, an unincorporated bush conservation group could enter into an auspicing agreement with a major children's charity to set up a series of bushwalks for the sick children and their families.

When is it appropriate to enter into an auspicing agreement?

Sometimes, not for profit organisations may not be able to obtain funding without being incorporated.

This can be a particularly time consuming process, particularly if an unincorporated organisation only wishes to obtain funding for a specific project. Auspicing offers such unincorporated organisations an alternative.

Similarly, organisations may not be able to carry on certain activities at certain locations without having appropriate insurance. Auspicing often allows unincorporated associations to take the benefit of certain components of the incorporated association's insurance policies. This could include their public liability insurance.

Key question

**What are the precise terms of the auspicing agreement?
Do they give your organisation adequate protection?**

Conducting Due Diligence

What is due diligence?

Due diligence is a process by which organisations critically examine each other's strengths and weaknesses before deciding to enter into a formal relationship. It lets organisations know what they are getting into. It is imperative that any due diligence process is thorough, and is not treated as a box ticking exercise.

A reminder

Due diligence must be a thorough and planned process.

The board of a not for profit organisation should delegate appropriate authority to the Chief Executive Officer and the Financial Controller to carry out the due diligence process.

They should be supervised by the board or, if the organisation is large enough, a dedicated sub-committee which will report to the board. They should be required to provide regular reports to the board. They must obtain competent legal and accounting advice that allows them to understand the potential financial and legal repercussions of their respective positions. JFMLAW has experience in providing just that sort of advice.

It is important to keep in mind that the board is ultimately responsible for ensuring that due diligence is carried out, and must be in a position to make a properly informed decision as to whether the formal relationship with the other organisation. To this end, the board must keep a close eye on the process.

How should due diligence be carried out?

Due diligence must be conducted by both organisations openly and in good faith. The organisations should offer all relevant information to each other, and should not seek to trick or deceive one another.

A reminder

Make sure that authority to engage outside advice is delegated to the CEO and Financial Controller.

Due diligence must be conducted by both organisations openly and in good faith. The organisations should offer all relevant information to each other, and should not seek to trick or deceive one another.

It is important for organisations each of the organisations to devise a due diligence framework document. This document should include:

- a) A checklist of considerations that are to be explored during the process. This will help to ensure that nothing is left out.
- b) A timetable for the process which outlines the deadline for specific tasks and the times at which the people conducting the process will be required to report to the board. This will ensure that the process is conducted in a timely manner which gives the board a sufficient period to review its results and make a final decision.
- c) A chart that outlines which people will be responsible for the various components of the process, and whom they will be required to report to.
- d) A budget for obtaining external legal and accounting advice.

A reminder

Make sure that all relevant records are available for inspection by the other organisation.

What should be included in the checklist of considerations?

The checklist of considerations should ensure that every matter associated with the other organisation that could pose a risk to the organisation conducting due diligence is explored.

At a minimum, it should address the items on the following pages.

DUE DILIGENCE

ITEM	USED
a) The financial position of the other organisation, including a review of all of its current and non-current assets and liabilities, any financial projections or plans that have been devised, and any auditor's reports that have been prepared.	<input type="checkbox"/>
b) The corporate and organisational structure of the other organisation, including a review of its constitution and its organisational chart.	<input type="checkbox"/>
c) The governance of the other organisation, including a review of the minutes of its meetings, the turnover of its senior executive staff and board members, and biographical information on its senior executive staff and board members.	<input type="checkbox"/>
d) The litigation and dispute resolution history of the other organisation, including an analysis of the nature and result of any litigation commenced or defended by the other organisation, and any regulatory dispute in which the organisation was involved.	<input type="checkbox"/>
e) The culture of the organisation and its board, including any board policies and procedures	<input type="checkbox"/>
f) The past and present business and marketing plans of the organisation.	<input type="checkbox"/>
g) The premises controlled by the other organisation, including a review of its compliance with work health and safety standards, its state of repair, and any lease or mortgage arrangements or other encumbrances.	<input type="checkbox"/>
h) The contracting arrangements of the other organisation with suppliers, independent contractors and other entities, including a review of their compatibility with the small business unfair contracts legislation.	<input type="checkbox"/>
i) The employment and contracting arrangements of the other organisation, including a review of human resources policies and procedures, employment contracts, the staff turnover, and any human resources disputes. It is vital to ensure that all employee and contractor entitlements have been properly and fully paid, and that all contracts and policies are compliant with the Fair Work Act 2009.	<input type="checkbox"/>

ITEM	USED
j) The values and purposes of the organisation, and their compatibility with the values and purposes of the organisation conducting due diligence.	<input type="checkbox"/>
k) The client base and stakeholders of the other organisation.	<input type="checkbox"/>
l) The intellectual property owned or licensed by the other organisation.	<input type="checkbox"/>
m) The relationship between the organisation and other not for profit organisations in the sector.	<input type="checkbox"/>
n) The relationship between the other organisation and any governmental bodies.	<input type="checkbox"/>
o) The compatibility of the data retention and information technology systems of the respective organisations.	<input type="checkbox"/>
p) Any incidents that were reported to the Ombudsman under the relevant mandatory reporting of incidents legislation.	<input type="checkbox"/>
q) The insurance policies that the other organisation has in place.	<input type="checkbox"/>

A reminder

Some of the considerations relate to technical matters. If you do not understand them yourselves, you must get external professional advice. If you find yourself in this boat, contact John Morrissey or Dominic Cudmore by calling (02) 9331 0266 or emailing jmorrissey@johnfmorrissey.com.au

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