

## ORGANISATION

# Governance issues in not-for-profit organisations

Not-for-profit (NFP) organisations have distinct and important differences to their *for profit* or commercial counterparts. Their governance attributes need to be respectful of these differences if optimal performance within an effectively managed acceptable risk profile is to be achieved.

Some key differences include:

- Their primary focus is *mission* driven, rather than primarily driven by financial return to shareholders (although this should not denigrate the importance of prudential financial management);
- The custodians of their mission and values are often an ill-defined group (including a combination of the organisation's members, board, employees, donors and community representatives), rather than being primarily only the board as is the case with *for profit* or commercial corporations;
- They operate on *mutual principles* where any returns from the organisation's enterprises are reinvested into its mission without passing through for the direct personal benefit of members of the organisation;
- Their mission is related to the service of, or provision of benefit to, others, usually with a laudable social or humanitarian focus rather than for shareholder returns and gains;
- They operate as communities, relying to a significant extent on the relationships with, and the goodwill and support of, a broad stakeholder group in order to sustain their organisational model;
- They operate under a different taxation regime than do *for profit* or commercial corporations;
- Accountability for their endeavours is to a diverse group including members, regulators, donors, government agencies and the broader society (having regard to the significant social interface of much of their endeavour), not just to shareholders, regulators and the markets – as is primarily the case with *for profit* or commercial corporations.

The basic precepts of good governance are fundamental to all organisations – having clarity of roles and responsibilities, a focus on strategic objectives and prudential risk management, appropriate financial management and disciplined accountability and transparency to members and stakeholders.

As part of the AICD's commitment to the NFP sector and its directors, it has developed the *Not-for-Profit Governance Principles*.<sup>1</sup> This publication is designed to assist boards in determining what constitutes good governance practice for their organisations and to better deliver the mission outcomes of those organisations through good governance. The 10 key Not-for-Profit Governance Principles are:

1. **Purpose and strategy** – the organisation has a clear purpose and a strategy, which aligns its activities to its purpose;
2. **Roles and responsibilities** – there is clarity about the roles, responsibilities and relationships of the board;
3. **Board composition** – the board's structure and composition enable it to fulfil its role effectively;
4. **Board effectiveness** – the board is run effectively and its performance is periodically evaluated;
5. **Risk management** – board decision making is informed by an understanding of risk and how it is managed;
6. **Performance** – the organisation uses its resources appropriately and evaluates its performance;
7. **Accountability and transparency** – the board demonstrates accountability by providing information to stakeholders about the organisation and its performance;
8. **Stakeholder engagement** – there is meaningful engagement of stakeholders and their interests are understood and considered by the board;
9. **Conduct and compliance** – the expectations of behaviour for the people involved in the organisation are clear and understood; and
10. **Culture** – the board models and works to instil a culture that supports the organisation's purpose and strategy.

## What is the nature of NFP organisations?

There are around 600,000 not-for-profit organisations in Australia, with some 4.6 million Australians contributing volunteer support to those organisations from time to time.<sup>2</sup> Of these, nearly 57,000 are 'economically significant' NFPs: that is, they are registered with the ATO (ABS, cat. no. 5256.0 – Australian National Accounts: Non-Profit Institutions Satellite Account, 2012-13). A further measure of the number of significant NFPs is the number registered with the Australian Charities and Not-for profits Commission (ACNC). In June 2019 there were 57,901 registered charities. They exist for the public good and can take many forms, such as charities, sporting groups, community groups, political associations, ethical groups, support groups, professional and trade associations, education and religious organisations.

The majority (some 440,000) of NFPs are small unincorporated organisations (that is, they do not have a distinct legal status from their members). For the remainder of NFPs with a formal legal status, the most common corporate structures are incorporated associations under relevant State or Territory incorporated associations acts (136,000) or companies limited by guarantee (12,000) (registered with ASIC). Other legal structures for NFPs include trusts, cooperatives (registered under State or Territory Cooperatives Acts), indigenous corporations (registered under special Federal legislation); religious organisations (including many which are statutory corporations) and organisations formed by Royal Charter or by a special Act of Parliament.

The duties and liabilities for directors in each of the types of formal legal structures are generally similar in nature, although there are some differences between the various pieces of legislation under which they are incorporated or registered.

1. Australian Institute of Company Directors, 2019, *Not-for-Profit Governance Principles*, January, <http://aicd.companydirectors.com.au/-/media/cd2/resources/director-resources/not-for-profit-resources/nfp-principles/pdf/06911-4-adv-nfp-governance-principles-report-a4-v11.ashx>, (accessed 23 September 2019).

2. Australian Government Productivity Commission, 2010, *Contribution of the Not-for-Profit Sector*, February, <https://www.pc.gov.au/inquiries/completed/not-for-profit/report/not-for-profit-report.pdf>, (accessed 23 September 2019).

These duties generally centre on the duties of a fiduciary including acting in good faith in the best interests of the organisation and for a proper purpose. In some cases, the governing group may be described as a management committee or council (rather than a board of directors). However, the duties and responsibilities are very similar notwithstanding the different description.

### Who regulates NFP organisations?

There are a number of different regulators of NFP organisations depending on the basis of their incorporation. These can largely be categorised into the following groups:

- **Charitable organisations** – the Australian Charities and Not-for-profits Commission (ACNC);
- **Non-charitable companies limited by guarantee registered under the Corporations Act 2001** – Australian Securities and Investments Commission (ASIC) and the ACNC;
- **Incorporated associations registered under State and Territory legislation** – the relevant State or Territory government Minister and Department;
- **Indigenous corporations** – the relevant Federal legislation under which they are registered. For many this is the *Corporations (Aboriginal and Torres Strait Islander) Act 2006* (CATSI Act), which is administered by the Registrar of Indigenous Corporations;
- **Co-operatives and mutuals** – the relevant State and Territory legislation under which they are registered;
- **Other statutory incorporated bodies** – the relevant legislation pursuant to which they are incorporated: for example, religious and educational organisations.

### What general governance challenges do NFP boards face?

As the size and complexity of NFP organisations in the sector have grown, the importance of good governance practice has also grown. Board composition is focusing more on relevant skills, knowledge and experience than merely passion for the cause or purpose. In larger NFP organisations, boards are becoming more professional including engaging directors with relevant experience and providing governance training for them.

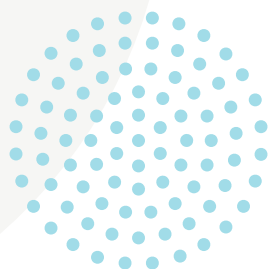
Specific issues include, but are not limited to, the following.

### Is there a clearly defined purpose and strategic direction?

NFPs have social purposes, missions or objectives to deliver against rather than merely focusing on financial returns (although financial sustainability remains an ever-important consideration). Clarity of mission, purpose and direction is important. There are significant risks associated with an unclear purpose, such as poor use of resources in terms of people and money, loss of confidence by donors and funding agencies, and potentially loss of reputation.

### What is the board's role?

In an NFP with a CEO/GM, the board's role will be similar to that of a company – to govern, not manage. In smaller NFPs like community groups, the board may be expected to take a more hands-on role in running and managing the organisation. Roles and responsibilities are best outlined in a governance charter and made available to members and other stakeholders.



### Stakeholder issues

By acting for more altruistic community and public social purposes, public expectations of NFP directors in the performance of their duties and responsibilities can be high. Stakeholders can include donors and funders, government agencies, customers, suppliers, employees, interest groups and the community at large. NFPs have to balance all needs with the best interests of the organisation. Appointments to the board to represent particular stakeholder interests can lead to factionalism, remembering that a director's duties are owed to the organisation as a whole.

### Lack of consistency in regulation

There is no centralised regulatory authority for all not-for-profit organisations. If operating nationally, an NFP may have multiple reporting obligations to various States and/or authorities, which can create a compliance burden. However, for charities which have one or more various tax exemptions such as income tax, GST, certain exemptions for fringe benefits tax or deductible gift recipient (DGR) status the ACNC is now a key regulator.

### Board composition

NFPs traditionally show a heavy reliance on their membership and stakeholder groups to fill board positions. A large proportion of directors are volunteers who may not necessarily have business financial or directorship experience. These boards risk not having appropriate skills, knowledge and experience to guide the organisation forward. Conducting regular evaluations of the board can assist in identifying future needs.



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### Potential legal exposure

Directors of NFPs face similar legal liabilities as company directors, in spite of many being volunteers. This highlights a number of important matters for NFP boards to consider:

- the importance of having properly documented procedures, policies and record keeping in place to minimise the risk of performance failure and also to better defend any actions against the organisation;
- training of board members, especially if directors are volunteers without a business/financial/directorial background (AICD offers training in this area);
- having an appropriate method of communicating with stakeholders and donors to ensure accountability; and
- the need for D&O insurance if things go wrong.

### Financial information

The board is responsible for clarifying what financial information it needs and ensuring that it gets this from management in a usable form. It may be helpful for the board to have predetermined criteria indicating the financial health of the organisation. Financial information should be presented to the board in a way that allows its members to readily check the financial health of the organisation. Directors should be able to read and understand the organisation's financial statements or be trained to develop this skill. NFPs face a number of reporting obligations to government agencies including:

- corporate and financial reporting associated with the legal structure under which they are incorporated;
- requirements of fundraising legislation;
- information required for endorsement for concessional tax treatment (as applicable);
- financial, governance and performance information required for obtaining or acquitting government funding (grants, etc.), or government funded service delivery contracts.

### Culture

The role of NFP boards in preventing major cultural failures has come to prominence in recent years. However, establishing and maintaining an appropriate organisational culture can be a challenge for many boards. The board, its directors and CEO all play critical roles in shaping an NFP's culture. This begins with the board deciding what kind of culture will best support the achievement of the organisation's purpose before taking step to develop and maintain the culture through monitoring and establishing the necessary policies to support that culture (for example, code of conduct, whistleblower policy).

### Basic procedures

NFP boards risk compromising their organisation's success by failing to get basic governance-related procedures right: for example, meetings running to time; board papers not being sent with enough time in advance; inadequacy of policies or a code of ethics; inadequate strategic planning risk management plans, succession plans, crisis plans. Having appropriate policies, organisational procedures, protocols and codes communicates the expectations the organisation has of its board members and other personnel.

### The 2019 Not-for-Profit Governance and Performance Study

Now in its 10th year, the AICD's Not-for-Profit Governance and Performance Study<sup>3</sup> is the largest of its kind in Australia. The 2019 report highlights more specific challenges facing NFP directors and the current areas of focus for NFP boards:

- Is the NFP directors' current time commitment sustainable?
- Board composition and director recruitment are ongoing challenges;
- Where is NFP director remuneration heading?
- NFPs are effective, but remain financially challenged;
- NFP mergers appear to be slowing down;
- Board performance is rated highly but directors see strategic planning and implementation as areas for improvement; and
- Challenges facing sporting organisations have evolved.

3. Australian Institute of Company Directors, 2019, *Not-for-Profit Governance and Performance Study: Key findings from the 10th edition*, July, <https://aicd.companydirectors.com.au/-/media/cd2/resources/advocacy/research/2019/pdf/07277-adv-nfp-governance-performance-study-2019-a4-68pp-web-2.ashx>, (accessed 23 September 2019).

## About us

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