Not-for-Profit Governance Principles

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General enquiries

t: 1300 739 119
e: nfp@aicd.com.au

National Office

18 Jamison Street
Sydney NSW 2000
t: 02 8248 6600
f: 02 8248 6633
e: contact@aicd.com.au

WE'RE FEELING SOCIAL, CARE TO JOIN US?

Foreword

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The not-for-profit sector makes an enormous contribution to Australia's social and economic welfare. Not-for-profits protect our environment, educate our students, enable us to practice our faith, celebrate our cultural heritage, and protect the most vulnerable in our community. Over a history of more than 200 years, not-for-profits have been a powerful and positive influence on the development of Australian society.

The Australian Institute of Company Directors (AICD) is committed to supporting not-for-profits and their boards to achieve good governance. The *Not-for-profit Governance Principles* (Principles) are demonstrative of this commitment.

The first version of the Principles was released in 2013. Their aim was to provide a practical resource to help not-for-profit boards and directors to achieve good governance.

Since that time, the sector has experienced significant regulatory reform and disruption. In recent years, great attention has been paid to the governance of not-for-profits and its role in maintaining the community's trust and in preventing misconduct, particularly against vulnerable people. It is fair to say that good governance has never been more important for the not-for-profit sector.

The Principles have been revised and developed considerably in this edition. They now include more detailed descriptions of governance and are accompanied by additional guidance. The aim is to help users of the Principles understand them better and apply them in practice. Of course, it will be a matter for each not-for-profit to carefully consider how best to apply the Principles to their own circumstances.

In developing this edition of the Principles, extensive consultation has been undertaken with directors, executives, policymakers and other stakeholders to ensure that it reflects the wisdom and insight of the broader not-for-profit sector. On behalf of the AICD, I express our gratitude to the many people who have contributed to the development of this resource which, we hope, will help not-for-profits in their important work.

I am delighted to present these Principles, and in doing so to reinforce the commitment of the AICD to standing with the not-for-profit sector as part of our goal to strengthen Australian society through world class governance.
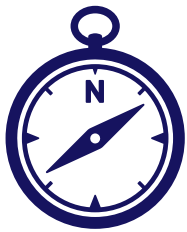
Angus Armour FAICD

Managing Director & CEO
Australian Institute of Company Directors

Snapshot of the Principles

Principle 1

Purpose and strategy

The organisation has a clear purpose and a strategy which aligns its activities to its purpose

1.1 The organisation's purpose is clear, recorded in its governing documents and understood by the board

1.2 The board approves a strategy to carry out the organisation's purpose

1.3 Decisions by the board further the organisation's purpose and strategy

1.4 The board regularly devotes time to consider strategy

1.5 The board periodically reviews the purpose and strategy

Principle 2

Roles and responsibilities

There is clarity about the roles, responsibilities and relationships of the board

2.1 Directors' roles are clear and understood by the board

2.2 Directors understand and meet their duties under the law

2.3 Directors meet any eligibility requirements relevant to their position

2.4 Delegations of the board's authority are recorded and periodically reviewed

2.5 The role of the board is clearly delineated from the role of management

Principle 3

Board composition

The board's structure and composition enable it to fulfil its role effectively

3.1 Directors are appointed based on merit, through a transparent process, and in alignment with the purpose and strategy

3.2 Tenure of directors is limited to encourage renewal and staggered to retain corporate knowledge

3.3 The board reflects a mix of personal attributes which enable it to fulfil its role effectively

3.4 The board assesses and records its members' skills and experience, and this is disclosed to stakeholders

3.5 The board undertakes succession planning to address current and future skills needs in alignment with the purpose and the strategy

Principle 4

Board effectiveness

The board is run effectively and its performance is periodically evaluated

4.1 Board meetings are chaired effectively and provide opportunity for all directors to contribute

4.2 Directors seek and are provided with the information they need to fulfil their responsibilities

4.3 Directors are appropriately inducted and undertake ongoing education to fulfil their responsibilities

4.4 The board's performance, as well as the performance of its chair and other directors, is periodically evaluated

4.5 The relationship between the board and management is effective

Principle 5

Risk management

Board decision making is informed by an understanding of risk and how it is managed

5.1 The board oversees a risk management framework that aligns to the purpose and strategy

5.2 Directors seek and are provided with information about risk and how it is managed

5.3 The board periodically reviews the risk management framework

Principle 6

Performance

The organisation uses its resources appropriately and evaluates its performance

6.1 The board oversees appropriate use of the organisation's resources

6.2 The board approves an annual budget for the organisation

6.3 The board receives and considers measures which evaluate performance against the strategy

6.4 The board oversees the performance of the CEO

6.5 The board monitors the solvency of the organisation

Principle 7

Accountability and transparency

The board demonstrates accountability by providing information to stakeholders about the organisation and its performance

7.1	The organisation's governing documents and policies relevant to its governance are available to stakeholders
7.2	The board oversees appropriate reporting to stakeholders about the organisation's performance and financial position
7.3	Transactions between related parties, if any, are disclosed to stakeholders
7.4	Directors' remuneration and other benefits, if any, are disclosed to stakeholders
7.5	Members have the opportunity to ask questions about how the organisation is run and to hold the board to account for their decisions

Principle 8

Stakeholder engagement

There is meaningful engagement of stakeholders and their interests are understood and considered by the board

8.1	The board understands who the organisation's stakeholders are, their needs and their expectations
8.2	The board oversees a framework for the meaningful engagement of stakeholders
8.3	Stakeholders are considered in relevant board decision making
8.4	There is a process for gathering and responding to complaints and feedback from stakeholders
8.5	The board oversees a framework for how the organisation works with and protects vulnerable people

Principle 9

Conduct and compliance

The expectations of behaviour for the people involved in the organisation are clear and understood

9.1	The board articulates its expectations of conduct, and the consequences for misconduct, for the people involved with the organisation
9.2	The board oversees compliance with relevant laws, regulations and internal policies
9.3	Conflicts of interest are identified, disclosed and managed
9.4	There is a process for investigating misconduct and relevant instances are brought to the attention of the board

Principle 10

Culture

The board models and works to instil a culture that supports the organisation's purpose and strategy

10.1 The board defines and models a desired culture that aligns to the purpose and strategy

10.2 The board oversees a strategy to develop and maintain the desired culture

10.3 The board oversees mechanisms to monitor and evaluate organisational culture

10.4 The organisation's values are clear, periodically reviewed and communicated to stakeholders

10.5 The board oversees a framework for the reward and recognition of workers

Contents

Introduction

The Not-for-profit Governance Principles (Principles) have been developed by the Australian Institute of Company Directors (AICD) as part of its commitment to promote good governance in the not-for-profit (NFP) sector.

The Principles are a practical framework to help NFPs understand and achieve good governance.

The original version of the Principles was published in 2013. This revised edition reflects the changes in the sector since that time, including the increased expectations of governance in NFP organisations. It also includes more detailed descriptions of good governance practices as well as additional guidance to support users to understand and apply the Principles.

Who this document is for

This document is for the people who are involved in the governance of NFPs. It is written for an audience of directors and executives, but other people involved in the governance of NFPs such as managers, staff and members may also find this document useful.

> **!** *In this document the term 'director' refers to the people who make up an organisation's board. In some organisations these people may be known as the board members, committee members, trustees, councillors, governors or by another name*

What is governance?

Governance refers to the systems that direct and control – or govern – an organisation.

Governance is about relationships. It concerns the relationships of the people involved with an organisation, both between each other and with the organisation itself, and the ways that the expectations of these relationships are understood and met. Governance enables authority to be exercised appropriately and for the people who exercise it to be held to account.

The Hon. Justice Neville Owen, who headed the Royal Commission into HIH Insurance, defined governance as:

"…the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations. It encompasses the mechanisms by which companies, and those in control, are held to account."

There is no one-size-fits-all approach to governance. Every organisation must consider its own circumstances in determining how best to develop a fit-for-purpose approach to governance. This should include consideration of factors such as an organisation's size, purpose, and structure.

The way organisations are governed (and the resources available to support this) will differ between organisations. Some organisations will have the resources to assist them in developing a sophisticated governance framework whereas smaller ones with scant resources may struggle to do this, instead relying on more informal approaches to help them achieve good governance.

That is not to say that good governance is more easily achieved by larger organisations.

All organisations can achieve good governance.

Consultation on the Principles

The AICD undertook extensive consultation throughout 2018 on the development of the Principles to draw on the experience and insight of directors, executives, their advisers and the broader NFP sector.

Consultation on the Principles included three components:

1. Release of a public consultation paper including draft principles and supporting practices for comment;

2. Focus groups with NFP directors; and

3. Consultation with the AICD's NFP Chairs' Forum, policy committees and division councils.

The AICD also established a steering committee to guide the development of the Principles.

Throughout the consultation process, strong feedback emerged that expectations of governance in the NFP sector have increased since the original edition of the Principles was published in 2013. Many NFP directors were seeking additional guidance on what good governance 'looks like' and welcomed a resource such as the Principles being expanded to help NFPs understand, apply and meet these expectations.

Consultation participants also observed the importance of understanding and accommodating the diversity of the NFP sector, recognising the variation in the size, resources and maturity of the organisations within it.

Feedback endorsed the development of a more detailed and practical document, informed by the experience of the NFP sector, which provides a framework to assist in the achievement of good governance. However, participants also expressed that it was important that any such resource be voluntary in application. This feedback is consistent with the AICD's objectives in developing this document.

This overview of the regulatory environment is current as at the date of publication, and NFPs should keep abreast of the latest developments relevant to their organisation.

The Principles will be subject to periodic review to ensure their ongoing currency and relevance. The AICD is interested in hearing from users of the Principles about their experiences and invites feedback by email to nfp@aicd.com.au.

"Good governance exists where an organisation has systems and processes in place that are appropriate to its circumstances, and which enable the organisation to pursue its purpose effectively and meet its obligations under the law."

ADDITIONAL RESOURCES

- Online versions of the Principles are available at **companydirectors.com.au/nfpprinciples** along with a suite of relevant tools and content to assist users

- Further NFP resources including director tools are available here: **companydirectors.com.au/ resources/not-for-profit-resources**

About the Principles

The Principles consist of three components:10 individual principles with supporting practices and guidance on each.

The principles

The cornerstone of the Principles is the 10 'principles'. Each of the 10 principles is explained by a heading and a high-level statement about an aspect of good governance (see Figure 1). Together, these principles provide a framework to understand governance in an NFP context.

> **!** *The word 'Principles' with a capital 'P' is used to refer to this document. The word 'principles' with a lower case 'p' is used to refer to the 10 individual principles set out in it.*

This document is structured around the 10 principles. The ordering of the principles aims to assist users to understand and apply them in practice and is not intended to indicate priority. It is important to note that the principles are interrelated and there is overlap between them.

Supporting practices

Each of the 10 principles includes several 'supporting practices' which describe activities or behaviours of organisations that are likely to be meeting the principles (see Figure 1).

The supporting practices are drafted in an outcomes-based way. They describe the outcome the supporting practice aims to achieve but do not prescribe how this is to be accomplished.

This structure is intended to provide flexibility for users to determine how to interpret and apply the supporting practices within their own circumstances. Two different organisations may demonstrate the supporting practices in very different ways.

Figure 1: Example principle and supporting practices

Principle	1	**Purpose and strategy**
		The organisation has a clear purpose and a strategy that aligns its activities to its purpose
Supporting Practices	1.1	The organisation's purpose is clear, recorded in its governing documents and understood by the board
	1.2	The board approves a strategy to carry out the organisation's purpose
	1.3	Decisions by the board further the organisation's purpose and strategy
	1.4	The board regularly devotes time to consider strategy
	1.5	The board periodically reviews the purpose and strategy

For example, there are several ways an organisation could demonstrate that it is meeting Supporting Practice 1.4.

The board might hold an annual strategy day, consider strategy at one meeting per quarter, or make strategy a permanent agenda item. Each of these ways are equally valid, but how effective they are in contributing to good governance will depend on how well they suit the circumstances of the organisation.

Guidance

Each of the principles and supporting practices is supported by guidance that aims to help users better understand their practical application.

The guidance includes two case studies that demonstrate how the principles and supporting practices can be applied. The case studies are based on two fictional organisations that are very different in terms of their purpose, activities, size and complexity. They are not reflective of any particular real organisation.

In the case studies both organisations are meeting the Principles in different ways which demonstrates that there is no one-size-fits-all approach to governance.

HelpfulCare

Helpful Care Services Limited was founded in 1916 in Melbourne's inner east to provide benevolent relief to children experiencing or at risk of homelessness. The organisation is a company limited by guarantee and is registered as a charity. Trading under the name of 'HelpfulCare', the organisation has grown to be a large and successful social service provider operating in all Australian states and territories.

Today HelpfulCare provides services to a range of clients including families, older Australians and people living with a disability. Among other things, HelpfulCare provides crisis accommodation, drug and alcohol counselling, out-of-home care and disability support services.

HelpfulCare has an annual operating revenue of approximately $150 million, most of which comes from government funding either directly through grant funding or indirectly under the National Disability Insurance Scheme. It also generates some revenue through philanthropic donations, investments and through several fee-for-service activities.

Approximately 650 people work for HelpfulCare and their work is supported by over 900 volunteers nationally. The board of HelpfulCare comprises six non-executive independent directors. Directors are appointed by the board and are the organisation's only members.

The Friendlies

The Friendly Community Group Inc. was established by a small group of friends in 2005 with the purpose of coordinating a volunteer effort to clean up a local creek in Kalgoorlie. After being profiled by the local paper the group grew, picking up some other projects including a breakfast club, an annual tennis tournament and a community gardening service.

Known affectionately in their community as 'the Friendlies', the group now comprises about 70 volunteers. In 2011, the Friendlies decided to amalgamate as an association. Anyone is welcome to become a member of the Friendlies and today the group has about 120 members, most of whom are current and former volunteers.

They have a small operating budget which fluctuates each year depending on the projects they are working on, which is generally about $50,000. Most of their project expenses such as food and building materials are donated by local business, but they also receive small grants from local government and benefit from community philanthropy.

The Friendlies board is made up of nine directors who are elected by the membership at their annual general meeting. The group has one part-time employee, but the majority of its operations are carried out by volunteers.

Using and reporting on the Principles

The Principles are a practical and voluntary framework to help NFPs understand and achieve good governance. Users will need to consider the Principles in their own circumstances and determine how best to use and understand them.

Not all aspects of governance that will be relevant to every organisation are considered in the Principles. For example, some NFPs that are trusts may not find *Principle 3: Board composition* useful because the way that trustees are appointed may not enable them to demonstrate the supporting practices.

Some organisations may also have additional governance requirements imposed by funding agreements or laws that apply to the organisation which go beyond what is included in the Principles.

Organisations that do not use or meet the Principles exactly may not necessarily be poorly governed, nor will those who use the Principles necessarily be well governed.

Using the Principles

The AICD encourages NFPs to use the Principles to help them to achieve good governance. Using and complying with the Principles is voluntary.

The Principles are not intended to be a stepping stone to regulation. Good governance cannot be achieved through a one-size-fits-all approach, and its features will differ between organisations based on their individual characteristics. The Principles also go beyond what may be considered a minimum standard of governance, and aim to encourage organisations to strive for and achieve good governance.

As such, the Principles are not suitable to be implemented as law or regulation. They should also not be read as a substitute for, or detracting from existing governance regulations, such as the Australian Charities and Not-for-Profits Commission (ACNC) governance standards.

It is not the role of the AICD to accept complaints about organisations that do not comply with the Principles.

Reporting against the Principles

The AICD encourages users of the Principles to conduct regular assessments of their performance against them and to report about the outcome of this assessment to stakeholders. It is a good idea to do this on an annual basis. Reporting on performance against the Principles provides a framework for organisations to communicate with stakeholders about their governance.

NFPs that report against them will need to consider what evidence they have that demonstrates they are achieving the Principles or the supporting practices. This exercise alone is a useful practice for boards as reporting its outcome to stakeholders can help increase trust, transparency and accountability.

The AICD encourages users to adopt an 'if not, why not' approach to reporting on the Principles. This means that where an organisation is not meeting any part of the Principles, they explain why this is so. For example an NFP may take the view that adherence to a principle or supporting practice may not be necessary or appropriate for their organisation. They should explain the rationale for this position.

There are a number of ways that an NFP could communicate to stakeholders about the Principles. For example, an NFP might produce a corporate governance statement which incorporates commentary on all aspects of the Principles. Some organisations may choose to list either the principles, the supporting practices or a combination of the two, and provide evidence that demonstrates how they are being achieved.

Context for the Principles

Understanding the environment in which NFPs exist is critical to understanding what good governance means for this important sector. NFPs operate in a diverse and often challenging operational context.

The NFP sector has undergone significant change since the release of the first edition of the Principles in 2013. Regulatory reform, disruption to funding patterns and an increasingly complex operational setting have reshaped the sector in many ways. This revised edition is intended to be reflective of these changes.

What is a not-for-profit?

An NFP is an organisation that does not operate for the profit or gain of its individual members, whether these gains would have been direct or indirect. This applies both while the organisation is operating and when it winds up.

Being an NFP does not mean that you cannot make a profit (sometimes called a 'surplus'). NFPs can make a profit provided it is used to further its purpose.

What is a charity?

A charity is an NFP that only has charitable purposes. All charities must be NFPs, but not all NFPs are charities.

Charitable purposes are defined under the law, most often under the *Charities Act 2013*, however state and territory legislation and the general law also may use different definitions of charitable purpose.

Charities registered with the ACNC must have only charitable purposes that are for the public benefit as defined in the *Charities Act 2013*. These organisations are referred to as 'registered charities'.

Background to the not-for-profit sector

The NFP sector is large and diverse, and has been a critical component of Australia's social and economic infrastructure for over 200 years.

According to the *Australian Charities Report 2016*, charities alone (which represent only a fraction of the broader NFP sector) employ 1.3 million people (10 per cent of the Australian workforce), engage 2.9 million volunteers and have a combined revenue of more than $142 billion. Every year, Australians give as much as $10.5 billion in donations and bequests to this important sector.

The great majority of NFPs in Australia are very small and are not separately incorporated. Of the roughly 56,000 that are registered charities, 67 per cent have less than $250,000 in annual revenue and 40 per cent have less than $50,000. Half of all these charities operate with no paid staff at all and rely entirely on volunteers.

The AICD's *2018 NFP Governance and Performance Study* (NFP Governance Study) has found that the great majority of NFP directors are unpaid, with only 16 per cent of directors receiving remuneration.

Diversity of the NFP sector

NFPs take many different shapes and sizes, and operate with many different purposes. NFPs may be involved in activities such as:

- Health and aged care;
- Social services;
- Education and research;
- Environmental protection;
- Arts and culture;
- Religion; and
- Sports.

There are also a number of different formal and informal structures that NFPs may take, including:

- Companies limited by guarantee;
- Incorporated associations;
- Indigenous corporations;
- Trusts
- Unincorporated associations;
- Cooperatives; and
- Statutory entities (organisations established by Acts of Parliament).

There are many other factors that contribute to the diversity of the sector, such as, the size and maturity of the organisations within it, as well as the people they work with, whether they have paid staff or not, and the locations in which they operate.

NFPs will be subject to different laws, regulations and standards based on factors such as:

- Their activities, such as being involved in child care or aged care;

- Legal structure;

- Legal status (such as registration as a charity or tax endorsements); or

- The locations in which they operate.

> **!** *The legal duties of directors are generally the same or very similar irrespective of the formal or informal structure the organisation takes.*

Regulatory reform

Over the past 10 years, the NFP sector has undergone substantial regulatory reform.

The ACNC was established on 3 December 2012 after almost two decades of campaigning from the sector for the establishment of a specialist, independent regulator of charities.

The introduction of the ACNC was a seismic shift in the regulation of charities. Financial and operational reporting for registered charities is now available to the public through the ACNC Register (acnc.gov.au/findacharity).

Some state and territory governments have taken steps to reduce red tape by introducing harmonised reporting with the ACNC, and it is likely that this trend will continue over the next few years.

Reform has also been undertaken at the state and territory level, including to the regulation of incorporated associations and cooperatives.

ACNC governance standards

Registered charities (except a limited class of charities called 'basic religious charities') must meet certain 'governance standards' to be and remain registered with the ACNC.

The governance standards are a set of five core, minimum standards of governance. Broadly, they require charities to pursue a charitable purpose, operate lawfully, and be run in an accountable and responsible way. They are intended to help charities maintain the trust and confidence of the community.

THE GOVERNANCE STANDARDS [1]

1: Purposes and not-for-profit nature
Charities must be not-for-profit and work towards their charitable purpose. They must be able to demonstrate this and provide information about their purposes to the public.

2: Accountability to members
Charities that have members must take reasonable steps to be accountable to their members and provide them with adequate opportunity to raise concerns about how the charity is governed.

3: Compliance with Australian law
Charities must not commit a serious offence (such as fraud) under any Australian law or breach a law that may result in a penalty of 60 penalty units or more.

4: Suitability of responsible persons
Charities must take reasonable steps to be satisfied that its directors are not disqualified from managing a corporation, or disqualified from being a responsible person of a registered charity by the ACNC Commissioner, and remove any responsible person who does not meet these requirements.

5: Duties of responsible persons
Charities must take reasonable steps to make sure that responsible persons are subject to, understand and carry out the duties set out in this standard.

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[1]   https://www.acnc.gov.au/for-charities/manage-your-charity/governance-standards

Operational environment

The operational context for NFPs has also changed substantially since 2013. Perhaps the most significant change has been to the funding practices of governments, including:

- Person-centred funding models such as the National Disability Insurance Scheme;

- Greater competition in tendering processes, both between NFPs and increasingly from for-profit providers;

- Amalgamating 'service areas' for some contracts, resulting in larger contracts being distributed among fewer recipients; and

- Growth in outcomes-based funding and the introduction of social impact bonds.

The impact of these changes has been felt in different ways. The AICD's 2016 NFP Governance Study revealed that 35 per cent of directors had discussed merger in the preceding 12 months, many doing so in response to market pressures and to become more competitive and effective. This means that the number and size of NFPs in Australia is fluctuating.

Many NFPs are exploring new ways to survive and prosper. The *Australian Charities Report 2016* revealed a growth in own-source income (such as from sales, member fees and user-pays services) to 50 per cent of the total of charitable revenue.

Many NFPs are being forced to become more commercial to remain competitive in response to the entry of for-profit providers into traditionally NFP-dominated markets. This is reflected in the growing number of social enterprises bringing commercial approaches to solving social and environmental problems.

Finally, it is worth noting that media reporting on misconduct and poor practice in the NFP sector has intensified in recent years, although not necessarily reflecting an increase in misconduct. In much of this reporting there has been direct or implied criticism of governance in the sector. Governance issues present in media reports have included:

" It is worth noting that media reporting on misconduct and poor practice in the NFP sector has intensified in recent years, although not necessarily reflecting an increase in misconduct."

· Harm to vulnerable persons;

· Fundraising and application of donor funds;

· Related party transactions and private benefit; and

· Director and executive remuneration.

Against this backdrop, the Edelman Trust Barometer has reported a global crisis in institutional trust. Although the NFP sector has historically enjoyed high levels of public trust, it has not been immune to the broader downward trend.

The impact of this trend has not been extensively explored in an NFP context, but it is a concerning development for a sector that relies on the trust and confidence of the community to achieve its goals.

The findings of the Royal Commission into Institutional Responses to Child Sexual Abuse have also highlighted the responsibilities of organisations working with vulnerable people, particularly children, and the role of governance in protecting them from harm. This focus is likely to continue through the Royal Commission into Aged Care Quality and Safety.

The future of NFP governance

As the NFP sector has changed, so too have the expectations the community has of it, particularly regarding its governance. Aside from failure to meet legal obligations, in many of the examples of misconduct and poor practice it is clear that community expectations of governance have not been met.

Governance must continue to mature to meet the challenges posed by a more complex and demanding operational environment. The record number of NFP directors and executives participating in AICD courses and events is one indicator of a growing consciousness of the importance of good governance to the sector.

There is no doubt that governance in NFP organisations has never been more in the spotlight. Amidst the change and uncertainty in the sector, strong and appropriate governance should be a critical priority for all NFPs.

Figure 2: 2018 Edelman Trust Barometer (institutions)
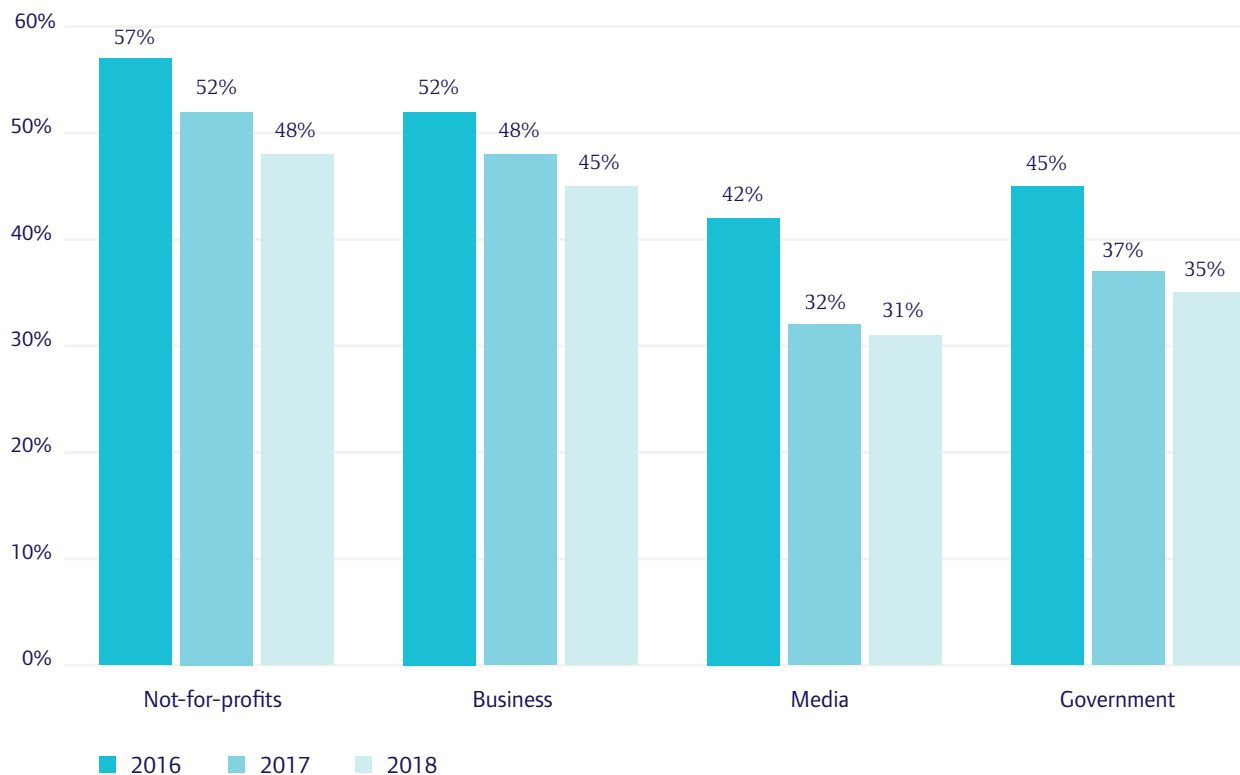
(Source: Edelman, *2018 Edelman Trust Barometer – Australia Results, March 2018*)

" *There is no doubt that governance in NFP organisations has never been more in the spotlight. Amidst the change and uncertainty in the sector, strong and appropriate governance should be a critical priority for all NFPs.*"

PRINCIPLE 1

PRINCIPLE 1

Purpose and strategy

The organisation has a clear purpose and a
strategy that aligns its activities to its purpose

1.1   The organisation's purpose is clear, recorded in its governing documents and understood by the board

1.2   The board approves a strategy to carry out the organisation's purpose

1.3   Decisions by the board further the organisation's purpose and strategy

1.4   The board regularly devotes time to consider strategy

1.5   The board periodically reviews the purpose and strategy

Every organisation will have a purpose. For the organisation to be successful the purpose must be clear, and there must be a strategy that sets out how the organisation will work towards achieving its purpose. There are five critical questions relevant to determining purpose and strategy:

?	*Why does this organisation exist?*
?	*What does this organisation do?*
?	*Who does this organisation benefit?*
?	*How will this organisation achieve its goals?*
?	*What does success look like for this organisation?*

What is a purpose?

An organisation's purpose is what it hopes to achieve. It is the reason the organisation exists, and all its activities should contribute to achieving its purpose in some way. It is the 'what' and the 'why' of an organisation's work. Purpose is the centrepiece of governance in the NFP sector.

NFPs are set up for many different purposes. For example, NFPs may have purposes such as:

- Promoting participation in a particular sport;
- Supporting the practice of a certain faith; or
- Providing accommodation and care to older Australians.

Some organisations may have more than one purpose. For example, a faith-based school might have the dual purposes of providing education and facilitating religious worship.

Some NFPs may have the same purpose for many years, while others may find themselves revising their purposes from time to time or creating new ones entirely. The role of the board in defining purpose will depend on several factors such as the maturity of the organisation or changes in its operational environment such as a cessation of funding.

Because purpose goes to the heart of an NFP's identity, any changes to it are often the product of a collaborative process involving considerable thought and debate.

Consideration of purpose will typically involve consultation between directors, staff, volunteers, members and other stakeholders such as clients and donors. It is important for an organisation's stakeholders to understand and support its purpose if it is to be successful in pursuing it.

> **!** *Registered charities must only have 'charitable purposes' as are set out in the Charities Act 2013 (Cth). These include purposes such as: advancing health, promoting reconciliation and preventing the suffering of animals.*

Understanding purpose

For an organisation to effectively and properly pursue its purpose, the people involved in the organisation must share a common understanding about the way that this is done. To do this, an organisation will have:

- Values that express what the organisation considers to be good; and
- Principles that express what the organisation considers to be right.

Together with purpose, these values and principles form the ethical framework of an organisation. This framework guides the decisions of the people involved in the organisation and should be reflected in its policies, systems and processes. The board should work to embed its ethical framework into all aspects of governance so that the organisation can pursue its purpose effectively and in the right way.

Organisational values are discussed in greater detail in *Principle 10: Culture*.

Communicating about purpose

An organisation's purpose should be communicated as clearly as possible so that it can be easily understood by everyone involved with the organisation. It is important that there is clarity about what an organisation aims to achieve and the way it does this.

There are many ways to communicate about purpose. Many organisations choose to express their purpose through a combination of mission and vision statements.

Mission statements describe what an organisation does to achieve its purpose. They are high-level statements and will generally aim to provide a clear and succinct summary of the reason the organisation exists.

For example:

- "To prevent cruelty to animals by actively promoting their care and protection" (RSPCA Australia);

- "To present opera that excites audiences and sustains and develops the art form" (Opera Australia); and

- "To support people who are blind or have low vision to live the life they choose" (Vision Australia).

Vision statements express what an organisation aims to achieve through its work by describing what the world would look like if they were successful in achieving their purpose. Vision statements are aspirational and should be something that inspires the people involved with the organisation.

For example:

- "All young Australians are supported to be mentally healthy and engaged in their communities" (headspace);

- "A world in which all children realise their full potential in societies that respect people's rights and dignity" (Plan International Australia); and

- "For cricket to be Australia's favourite sport, and a sport for all Australians" (Cricket Australia).

The way an NFP defines and expresses its purpose is a matter for the board, but careful consideration should be given to the way this is done so that any legal obligations are met. For example, changes to an organisation's purpose may affect its eligibility to access certain tax concessions or registration as a charity.

It is common for an NFP's purpose to be set out in its governing document, usually in the form of 'objects'. Mission and vision statements are often used to develop the organisation's objects so that they can be more easily communicated and understood.

> **!** *In this document the term 'governing documents' refers to the documents that set out how an organisation must be run. These documents are usually known as the constitution, charter, rules or articles of association.*

In some cases, an organisation's purpose may be recorded in several different documents. An organisation might have relatively simple objects recorded in its constitution which are developed in greater detail through other sources such as its strategic plan.

Wherever an organisation's purpose is recorded, it is important that it is clear and understood by everyone involved in the organisation, including the board.

Can an organisation's purpose change?

An organisation's purpose may change over time. For example, the organisation may have achieved its goal, or a new goal may have arisen. Boards should regularly review their purpose to make sure that it is still relevant and make changes if necessary.

> **!** *An organisation's governing documents and any laws that apply to it may set out requirements about how an organisation's purpose can be changed, including any limits on what the purpose can be.*

How often a purpose needs to be revisited will depend on the nature of the organisation and what its purpose is. Some purposes may last forever (for example, "to educate the children of Toowoomba") whereas others may be time limited (for example, "to commemorate the centenary of the ANZAC").

Sometimes, an NFP's activities may drift away from its purpose over time because of a lack of control or because the relevance of the purpose has diminished. This is called 'mission drift.' This can give rise to significant problems and it is important that the board monitors alignment between the organisation's activities and purposes, and takes steps to address misalignment if it occurs.

It is a good idea to seek legal advice before changing a purpose, as even small changes may have significant impacts, such as to an NFP's entitlement to access certain tax concessions. Changes to purpose may also be constrained by other factors, such as the terms of grants and bequests

Having a not-for-profit purpose

Purpose is important for NFPs, but it is not what sets them apart from for-profit organisations (businesses). Many for-profit organisations also have a purpose (for example, Telstra's purpose is "to create a brilliant connected future for everyone"). What sets NFPs apart is that their purposes are "not-for-profit".

The ACNC provides the following definition of NFP:

MEANING OF NOT-FOR-PROFIT

Generally, a not-for-profit is an organisation that does not operate for the profit, personal gain or other benefit of particular people (for example, its members, the people who run it or their friends or relatives). The definition of not-for-profit applies both while the organisation is operating and if it 'winds up' (closes down) i.e. assets and income of the organisation shall be applied solely to further its objects and, no portion shall be distributed directly or indirectly to the members of the organisation, except as genuine compensation for services rendered, or expenses incurred on behalf of the organisation.

This definition does not mean that the people involved with an NFP cannot benefit from it, provided this benefit is consistent with the NFPs purpose. For example, an NFP could provide aged care services to its members provided its purpose was to provide those services. By comparison, if an aged care service made a profit from its operations, it could not share these profits with their members. This would be private benefit and not consistent with being an NFP.

In most cases, NFPs are required by law to have clauses in their constitution requiring the organisation to operate as an NFP. These clauses should set out how an NFP's assets and income are to be used when it is operating and if it winds up.

The ACNC provides example clauses that NFPs can use:

NOT FOR PROFIT CLAUSE

The assets and income of the organisation shall be applied solely to further its objects and no portion shall be distributed directly or indirectly to the members of the organisation except as genuine compensation for services rendered or expenses incurred on behalf of the organisation.

THE DISSOLUTION CLAUSE

In the event of the organisation being dissolved, all assets that remain after such dissolution and the satisfaction of all debts and liabilities shall be transferred to another organisation with similar purposes, which is charitable at law and which has rules prohibiting the distribution of its assets and income to its members.

What is strategy?

If an organisation's purpose is the 'what' and the 'why' of its work, strategy is the 'how.' Strategy brings the organisation's purpose to life by setting out the way by which it will be achieved.

"…If you don't know where you're going, any road will get you there, said the Cheshire Cat to Alice…"

Lewis Carroll, *Alice's Adventures in Wonderland*, 1865

Strategy is the way an organisation defines its goals and aligns activities and resources with them. Strategy is also inherently linked with risk which is discussed in greater detail in *Principle 5: Risk management*.

Many organisations will develop a single document to express their strategy. This helps with communicating the strategy to the people involved in the organisation. Wherever a strategy is recorded, it is important that it is clear, understood by relevant stakeholders and that board decision-making processes are aligned to it.

Strategic planning

Many organisations use strategic plans to define how resources and activities will be aligned to a set of goals within a defined period. Strategic plans typically include several high-level goals which span several years and are reviewed at regular intervals.

Strategic plans make it easier to understand and communicate how an organisation is pursuing its purpose. Most strategic plans also include measures which are used to evaluate its performance. They can be useful tools to communicate with stakeholders about strategy, but they are not a strategy in and of themselves.

For many organisations, the process of strategic planning is as important as the plans that result from it. Strategic planning gives organisations the opportunity to reflect on their goals and to develop an understanding of their operational environment which assists in the development and execution of strategy.

The board's role in strategy

Strategy is a key responsibility of the board. How the board performs its role in developing strategy will vary depending on the organisation's characteristics.

Some boards will take an active role in strategy development, working with management and other stakeholders to define and communicate their short and long-term strategic direction. In other circumstances, the board may test and approve the strategy, but it will be substantively developed by management.

> **!** *In this document the term 'management' is used to refer to an organisation's staff, typically, the CEO and executive staff. Not all NFPs employ staff, so in some circumstances this term may not be relevant.*

Whatever the board's contribution to strategy development may be, its role in providing strategic thinking in decision-making is critical. Because directors are not generally involved in the day-to-day operations of a business, they are able to bring a more high-level perspective to their work. This is one of the most significant ways that boards can contribute to the effective governance of their organisations.

It is common in NFP organisations for directors to be more 'hands on', however care should be taken that this does not prevent them from bringing the necessary focus and attention to their role.

For example, boards might consider strategic questions such as:

> **?** *What decisions do we need to make now to meet future financial needs?*

> **?** *To what extent are we prepared to tolerate failure in pursuit of innovation?*

> **?** *How does the community's perception of us impact our ability to achieve our objectives?*

Boards should apply a strategic lens to their decision-making. This means that they should make their decisions in the context of the strategy, but also consider how their decisions may impact the organisation's strategy. For example, a decision they make could mean that the strategy needs to be amended.

Making time for strategy

There are many issues that demand boards' attention. Although boards should consider the organisation's strategy in all aspects of their work, they should also make time to consider the strategy directly.

Good strategy is designed to suit an organisation's operational environment. As a result, strategy must adapt to changes in the organisation's context to remain effective. Boards should review the strategy periodically and whenever a significant change might impact its execution.

It is common for boards to reserve time in their annual calendar dedicated to discuss and think about strategy. Some boards will do this by making strategy a standing agenda item while others may hold regular strategy days. Whatever the case, it is a good idea to create space to address strategy separately from other matters.

QUESTIONS FOR DIRECTORS

IS THE ORGANISATION'S PURPOSE CLEARLY ARTICULATED AND COMMUNICATED TO STAKEHOLDERS?

HOW DOES THE BOARD KNOW IF THE ORGANISATION'S ACTIVITIES ARE ALIGNED TO ITS PURPOSE?

HOW FREQUENTLY DO THE PURPOSE AND STRATEGY NEED TO BE REVIEWED?

HOW DOES THE BOARD ALIGN ITS DECISION-MAKING WITH THE STRATEGY?

IS TIME SET ASIDE IN THE BOARD'S AGENDA TO CONSIDER STRATEGY?

CASE STUDIES

HelpfulCare

HelpfulCare's purpose is recorded in its constitution as: "To support people in need through the provision of world-class services delivered with the care of a family." To bring their purpose to life, they have developed a policy document called 'Being HelpfulCare' which explains what their purpose is, what it means and how it is incorporated into their operations.

The board of HelpfulCare has approved a rolling five-year strategic plan which was developed by their Chief Executive Officer (CEO) under the supervision of the board who set expectations of timeframes and consultation. The strategic plan articulates five key goals which help give form to the organisation's purpose. The board reviews progress towards achieving their strategic goals annually and, as part of that, reflects on how effective its strategy has been. If necessary, the strategy is refined or changed. It also formally reviews its strategic plan mid-way through its life.

To assist with making strategic decisions, the board of HelpfulCare requires management to provide at least a short explanation for any matter they are asking the board to make a decision on, describing how the issue relates to the achievement of their purposes. Agenda items and management reports are also categorised based on which strategic plan goal they relate to so that the board is always thinking about the relationship between their work and the strategy.

Strategy is a standing agenda item at every second board meeting and the board of HelpfulCare has a dedicated annual strategy day where directors meet for an extended period to discuss strategy, changes in their operational environment and 'big picture' ideas.

The Friendlies

The Friendlies' purpose is recorded in their constitution as "to facilitate and coordinate the goodwill and generosity of the local community." They have developed an 'organisational charter' that expands on this, describing the three main ways through which they aim to achieve this goal.

Every year in December the Friendlies hold a 'community planning day' where they identify three key goals for the year through a consultative process with their members. These goals are then communicated to members and other stakeholders in their monthly newsletter and on their Facebook page. They are reported on at the end of the year in their annual report. This forms their strategic plan.

Twice a year the Friendlies' board holds a half-day meeting at which they meet with members to talk about their progress towards achieving their purpose and make any refinements necessary based on their consultation.

PRINCIPLE 2

PRINCIPLE 2

Roles and responsibilities

There is clarity about the roles, responsibilities
and relationships of the board

2.1   Directors' roles are clear and understood by the board

2.2   Directors understand and meet their duties under the law

2.3   Directors meet any eligibility requirements relevant to their position

2.4   Delegations of the board's authority are recorded and periodically reviewed

2.5   The role of the board is clearly delineated from the role of management

To achieve good governance, the roles of the people involved in an organisation and their relationships to one another must be clear and understood. Because directors are at the top of the organisational hierarchy, they must make sure that they understand and meet the responsibilities of their roles.

> **!** *In this document the term 'director' refers to the people who make up an organisation's board. In some organisations these people may be known as the board members, committee members, trustees, councillors, governors or by another name.*

What is a director?

A director is someone who is validly appointed to be director of an organisation. Together, the directors of an organisation form an organisation's board and collectively have ultimate responsibility for the company. The process for appointing a director will generally be set out under an organisation's governing documents.

The law also recognises other people who are not formally appointed as directors but who act as directors (de facto directors), or people with whose instructions or wishes directors are accustomed to act (shadow directors). In some circumstances, it is also possible for a director to nominate another person to act in their place (alternate directors), although this will depend on the organisation's governing documents and any laws that apply to it.

Before accepting a position as a director, it is a good idea to ask:

> **?** *Do I understand the responsibilities of this role, including my legal duties?*

> **?** *Am I prepared to dedicate the time and energy to perform this role in the way required?*

> **?** *Do I have the skills and experience to discharge the responsibilities of directorship?*

Only if the answer to these questions is 'yes' should a person accept the responsibilities of directorship.

Sometimes a director of an NFP may also have other roles within the organisation. For example, a director of a sporting club may also be a coach, a player or a parent of a player. It is important for directors to be able to separate these roles and not allow one to improperly influence the other.

Who can be a director?

Generally, directors must be people over the age of 18 and who consent to taking on the responsibilities of the position. Otherwise, there is generally no particular qualification or experience level necessary to become a director under the law.

There may be requirements in an organisation's governing documents or in the laws that apply to it that set out eligibility requirements for directors. For example, if you are an undischarged bankrupt, you cannot be a director of a company under the Corporations Act.

Directors should know whether they are subject to any eligibility requirements and be satisfied that they continue to meet them. It is a good idea to set out any eligibility requirements for directors in a letter of appointment, and to regularly review whether all directors continue to comply with these requirements.

Directors' duties

There are two sources of directories duties: general law and statute.

Under the general law, directors have duties that are based on the relationship they have with the organisation. This is a special relationship based on trust; a relationship akin to being the trustee of someone else's money, and for this reason directors' duties are sometimes called 'fiduciary duties'.

Directors' duties are usually also set out under statute, though the way this is done will depend on how the organisation is incorporated.

The four main legal duties based on general law and statute are to:

1. **Act in good faith and for a proper purpose**
   This duty has two parts. Firstly, acting in 'good faith' means that directors must act honestly, fairly and loyally. It requires that directors act in the best interests of the organisation (rather than in their own personal interests). The requirement to act for a 'proper purpose' means that a director's decisions must further the organisation's purpose and be made within the board's legitimate authority.

2. **Act with reasonable care, skill and diligence**
   Directors must take their roles seriously and be diligent in the exercise of their responsibilities. That includes taking the necessary time to prepare for

board meetings, keeping abreast of the organisation's activities and understanding the organisation's financial position (including making sure the organisation can pay its debts when they are due), and attending and participating in board meetings.

3. **Not to improperly use information or position**
   Information provided to directors to support them to fulfil their roles must only be used for the benefit of the organisation. Directors cannot use information provided to them as a director, or their role as a director, to harm the organisation or to gain an improper advantage for themselves or another person or organisation.

4. **Disclose and manage conflicts of interest**
   Conflicts of interest are often unavoidable. They do not represent a problem in and of themselves. However, where a conflict of interests do arise, directors must disclose them, and manage them appropriately. Conflicts of interest are explored in more detail in *Principle 9: Conduct and compliance*.

There is some misconception that directors who are not remunerated for their work (sometimes called 'volunteer directors') are subject to lower standards of legal responsibility. This is not the case, and individuals should think carefully before accepting the responsibilities of directorship.

There are several laws that set out the specific duties to which directors are subject. For example, there are directors' duties under the common law, the laws that govern incorporated associations and under the Corporations Act. The ACNC governance standards also refer to directors' duties.

ACNC GOVERNANCE STANDARD 5: DUTIES OF RESPONSIBLE PERSONS

- To act with reasonable care and diligence;

- To act honestly and fairly in the best interests of the charity and for its charitable purposes;

- Not to misuse their position or information they gain as a responsible person;

- To disclose conflicts of interest;

- To ensure that the financial affairs of the charity are managed responsibly; and

- Not to allow the charity to operate while it is insolvent.

Often an organisation's governing document will also set out certain legal duties and require directors to comply with them. The ACNC has published a template constitution for NFP companies limited by guarantee which is a useful resource for organisations.[2]

It is a good idea in a letter of appointment for all new directors to set out the legal duties and to revisit these regularly as part of ongoing director development so that directors understand and are meeting them. This is discussed in greater detail in *Principle 3: Board composition* and *Principle 4: Board effectiveness*.

There also are other specific legal obligations imposed on directors regarding issues such as work health and safety, tax and the environment.

To whom do directors owe their duties?

Directors' duties reflect the relationship that directors have with the organisation and its members. Directors are entrusted with the responsibility of governing an organisation and so the law expects that they will act in the best interests of the organisation and be accountable for their actions.

Directors owe their duties to the organisation as a whole – meaning that they must act in the best interests of the organisation and its members. It is assumed that the organisation will exist on an ongoing basis (in perpetuity), and as such the interests of future members should also be considered.

In exercising their responsibilities, it is a good idea for directors to consider how their decisions might impact other stakeholders who are not members, such as clients and community members. This may be beneficial to the organisation's strategy and assist with improved decision-making, but it is important to recognise that directors do not have a specific legal duty to act in the interests of these stakeholders (aside from obligations arising from other specific laws, for example regarding environmental protection or WHS).

Some directors are appointed to the board to contribute the perspective of a certain stakeholder group. For example, a federated organisation might appoint directors from its state and territory divisions to its national board. This can provide valuable insight and promote a sense of involvement among stakeholders.

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2   https://www.acnc.gov.au/tools/templates/constitution-charitable-company-limited-guarantee

However, it is important to recognise that even though a director may be appointed because of their relationship to a stakeholder group, they must exercise their duties in the interest of the organisation and apply an independent mind to their responsibilities.

Role of the board

The board is responsible for the overall governance, management and strategic direction of the organisation. As a result, the board has ultimate accountability for its activities and performance. Boards are comprised of an organisation's directors who can only exercise their authority when acting as a collective.

This also means that directors may still be held legally responsible for decisions of the board, even though they may not have supported it individually.

> ❗ *In this document the term 'board' refers to an organisation's governing body (its directors acting as a collective). In some organisations these people may be known as the committee of management, council or by some other name.*

The role of the board may vary slightly depending on the nature of the organisation. The boards of smaller or newer organisations, or those without paid staff, may have a more operational focus, whereas the boards of larger and more established organisations may take a more strategic approach to their work. Boards must decide for themselves how best to contribute to their organisation to make a positive impact and to meet their duties under the law.

The role of the board can be broken down into six different dimensions:

Strategy
Establish strategies to guide, monitor and control the organisation's activities.

Resources
Make resources available to achieve the strategy and oversee their use.

Performance
Monitor the organisation's performance.

Compliance
Oversee processes to comply with legal and regulatory requirements.

Risk
Oversee a risk management framework that supports informed decision-making by the organisation.

Accountability
Report progress and align the collective interests of members, stakeholders, board, management and employees.

To assist in defining the role of the board and understanding its legal obligations, many boards choose to develop a board charter to govern the way the board works and fulfils its responsibilities. This is a document that sets out the respective roles, responsibilities and authorities of the board.

Delegation of the board's authority

The board has ultimate responsibility for and control over the way an organisation is run, except in some matters which may require the involvement of members (such as changing the organisation's governing documents). However, boards can choose to delegate part of their authority to others, such as an organisation's staff and volunteers.

An organisations' governing documents (particularly its constitution) and any other laws that apply to it may limit the ability of the board to delegate its authority.

There are some parts of the board's authority that are considered good practice to be reserved for the board or which the board may be required to retain under the law, for example:

· Appointing, overseeing and evaluating the performance of the CEO;

· Approving the budget and strategy; and

· Reviewing and approving financial reports.

It is important that any delegation of the board's authority is clearly defined and recorded appropriately and regularly reviewed. One of the ways this can be done is through establishing delegation policies that set out which of the board's authorities are being delegated and the circumstances under which they can be exercised.

> ❗ *The board may delegate some of its authority, but it cannot delegate its responsibility. The board is still ultimately accountable for any of its powers that are exercised by others on its behalf.*

Board committees

Many boards establish committees to assist with their work. Committees can also be a helpful way to build and access expertise as committee members do not necessarily have to be directors. Some committees may operate for a defined period (for example, to oversee the appointment of a new CEO) and are referred to as 'ad hoc committees.' Others may operate on an ongoing basis (for example, a fundraising committee) and are referred to as 'standing committees'.

For example, many boards will establish an audit committee to assist the board on an ongoing basis with oversight of financial reporting and the appointment of the auditor.

> **!** *Although the board may delegate some of its responsibility or authority to a committee, the board is still accountable for the operation of its committees and for the use of any delegated authority by those committees.*

One way this can be done is through establishing a committee's 'terms of reference' which include:

- What the committee's purpose is;
- What its powers are (if any);
- Who its members will be;
- Who its chair will be;
- How often it will meet;
- How it will report to the board; and
- How often it will be reviewed.

The role of the chair

In the boardroom, the chair is *primus inter pares* – first among equals. Their role is to manage the business of the board both inside and outside of the boardroom. The chair does not hold greater authority than any other director but will generally have additional responsibilities.

> **!** *In this document the term 'chair' refers to the person who leads and manages the business of the board. In some organisations this person may be known as the president, convenor or by some other name.*

In the boardroom, the chair has a number of responsibilities such as facilitating discussion, ensuring that agenda items are dealt with in sufficient detail and that decisions are made appropriately.

The chair also has a number of responsibilities outside the boardroom including overseeing an appropriate flow of information to the board and maintaining a close link between the board and management. The role of the chair is often characterised as managing the business of the board because the chair is generally responsible for board's operations, including setting its agenda and approving board papers. It is important that there is a strong, collegiate relationship between the chair and the CEO.

The role of the chair is generally not set out in law. However, an organisation's governing documents may set out requirements such as how the chair is appointed and what their responsibilities are.

The role of the company secretary

Many boards appoint a company secretary (in some NFPs this person could be called the 'public officer') to facilitate corporate governance processes and support the operation of the board. The company secretary generally has responsibility for coordinating board minutes and papers, and monitoring compliance of the board and its committees with the law, the organisation's governing documents and its internal policies. For companies, the Corporations Act specifically requires that the board appoint the secretary (s204D).

It is common for the company secretary to also have other roles within the organisation such as being general counsel. In smaller NFPs, the company secretary is often one of the directors.

The company secretary often has other obligations outside the boardroom. For example, the company secretary may take on responsibility for liaising with regulators on behalf of the board and complete timely and proper completion of any returns, such as the obligation of charities to notify the ACNC when a director is added or removed from the board. The organisation's governing document or the laws that apply to them may also set out specific responsibilities for the company secretary.

It is common for the company secretary to report both to the CEO and to the board. Directors should be able to communicate directly with the company secretary without having to go through the CEO. Often the decision to appoint and remove a company secretary will be left to the board.

> **!** *An organisation's governing documents and any laws that apply to it may set out requirements about who can be appointed as company secretary and the way this must be done.*

The role of management

Directors act collectively to provide governance and oversight of an organisation and will typically meet several times per year for a limited period of time. It is not practical for boards to direct the day-to-day operations of an organisation, or to perform themselves the tasks necessary for an organisation to achieve its goals. For this to happen, the board must delegate some of its authority to 'management' (paid or unpaid workers).

For example, the board will generally delegate authority for the CEO to use the organisation's financial resources within the limits set by the budget and in alignment with the strategy. It is important that any delegation of the board's authority to management is recorded and regularly reviewed.

> **!** *Although the board may delegate some of its responsibilities or powers to management, the board is still ultimately accountable for management and for the use of any delegated authority by management.*

The board oversees the strategy while management develops and implements the plans to achieve it. Boards are expected to operate on a more long-term and strategic basis. By comparison, management should be concerned with the more immediate operational needs of the organisation.

"A company in many ways may be likened to a human body. It has a brain and a nerve centre which controls what it does. It also has hands which hold the tools and act in accordance with directions from the centre. Some of the people in the company are mere servants and agents who are nothing more than hands to do the work and cannot be said to represent the mind or will. Others are directors and managers who represent the directing mind and will of the company and control what it does."

Lord Justice Denning, *HL Bolton (Engineering) Co Ltd v TJ Graham and Sons Ltd*, 1957

In practice, the division of responsibility between the board and management may be less defined. It may be possible in theory to divide responsibilities between the board and management, but it is likely that the line between the two will shift as an organisation's needs and environment changes.

Boards should take an active role in considering where this line is drawn and in reviewing whether the focus of their discussions is appropriate to make sure they, and management, are making the most impactful contribution to the organisation.

QUESTIONS FOR DIRECTORS

DO DIRECTORS UNDERSTAND AND MEET THEIR RESPONSIBILITIES, INCLUDING LEGAL DUTIES?
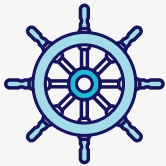
ARE THE ROLES AND RESPONSIBILITIES OF THE BOARD AND INDIVIDUAL DIRECTORS CLEAR?

ARE ANY DELEGATIONS OF THE BOARD'S AUTHORITY CLEARLY RECORDED AND REGULARLY REVIEWED?

IS THERE AN APPROPRIATE SEPARATION BETWEEN THE ROLE OF THE BOARD AND OF MANAGEMENT?

ARE DIRECTORS SUBJECT TO ANY ELIGIBILITY REQUIREMENTS AND ARE THEY CONTINUING TO MEET THEM?

CASE STUDIES

HelpfulCare

The board of HelpfulCare has established a board charter that broadly sets out the roles and responsibilities of its directors, the eligibility requirements that apply to them, and their duties under the law. The charter is a board-approved policy document and is reviewed annually so that it is relevant and to keep it fresh in the minds of directors.

HelpfulCare also has a board policy handbook that includes a range of governance policies about how the board will operate. The handbook includes policies that explain in detail the roles and responsibilities of directors, the chair, the CEO and the company secretary.

The handbook also includes a policy on how the board will use committees. In line with the policy, the board of HelpfulCare has established three committees, each with its own terms of reference that are approved by the board and reviewed every two years. The HelpfulCare board has an audit committee, a risk committee; and a nominations committee.

The board's delegation policy sets out how the board's powers may be delegated to management or to committees. The policy also requires that any delegation be reviewed after a certain period. Delegations of the board's authority are also recorded in a register so there is clarity for the people involved with the organisation on who has delegation and how it is to be exercised.

The Friendlies

When calling for nominations for directors, the Friendlies provides a copy of a position description for directors which explains what the board and directors do.

When people are appointed as directors, they receive a letter of appointment from the chair which sets out the expectations of their roles. The letter includes matters such as eligibility requirements for directors, minimum attendance at board meetings and their general legal duties. Directors are required to sign and return the letter, which affirms that they understand their responsibilities and meet the relevant eligibility requirements, and they will advise the board if they are no longer eligible.

The Friendlies employ one staff member (their part time coordinator). Their position description is set out in their employment contract, which also explains their responsibilities and their relationship to the board.

The Friendlies do not have any ongoing committees. However, from time to time they establish ad hoc committees for specific projects. In the past they have had committees for coordinating their ten-year anniversary and for reviewing their constitution. When they established the committees and their terms of reference, they also record these details in the board minutes.

PRINCIPLE 3

PRINCIPLE 3

Board composition

The board's structure and composition enable it to fulfil
its role effectively

3.1 Directors are appointed based on merit, through a transparent process,
and in alignment with the purpose and strategy

3.2 Tenure of directors is limited to encourage renewal and staggered to retain
corporate knowledge

3.3 The board reflects a mix of personal attributes which enable it to fulfil its
role effectively

3.4 The board assesses and records its members' skills and experience, and this
is disclosed to stakeholders

3.5 The board undertakes succession planning to address current and future
skills needs in alignment with the purpose and the strategy

Having the right people around the table is critical to the effectiveness of a board. Boards should look critically at who their directors are and how they are appointed. There is no one-size-fits-all ideal structure and composition for boards. Instead, the directors must decide what form their board should take and give consideration to how this might change over time.

Appointing directors

Directors are generally appointed by:

· direct appointment by the board; or

· election by the members.

Organisations may use either of these methods or a combination of the two. Generally, an organisation's governing documents and any laws that apply to it will set out requirements about who can be appointed as a director and by what process they must be appointed.

It is a good idea to set out the process for appointing directors in a policy. This policy should include matters, such as who is eligible to be a director, how they can nominate and any processes that must be followed so that their appointment is valid. Making this policy available to stakeholders, especially members, can help promote transparency and will help prospective directors to understand the process.

If directors are appointed by election, it is important the process is transparent. One way that this can be achieved is through appointing an impartial third party (sometimes called a 'returning officer') to oversee the process so that it is fairly and properly run. Often an organisation's governing documents will set out the requirements in relation to the election process.

Tenure of directors

Directors are generally appointed for a fixed term. The total time that they are appointed for (which may include several terms) is referred to as 'tenure'.

Once a director's term concludes they will either be reappointed for another term or they will cease to be a director. An organisation's governing documents will generally set out requirements about how long a director is appointed for, whether they can be reappointed and,

if so, whether there is a limit to the number of terms (or years) that a person can serve as a director.

It is a good idea for a director's tenure to be limited to encourage renewal. Although there may be good reason for a director to serve for an extended period in certain circumstances, there are many benefits to bringing fresh perspectives onto a board.

Boards should consider how a director's tenure may impact their performance, particularly if serving for ten years or longer. Even if a director does serve for an extended period, limiting tenure will encourage regular review about whether their appointment continues to be in the best interest of the organisation.

It is also important to consider how the mix of tenure on a board might affect the retention of institutional knowledge. If too many directors depart at once, this could result in the loss of important history and context, which helps the board to make good decisions. Directors also play an important role in mentoring their peers and so it is important that new directors can work with, and learn from, more experienced directors as part of their induction process.

For this reason, it is a good idea to stagger board tenure so that the number of departing directors, new directors and ongoing directors is balanced.

Measuring skills and experience

To understand what skills they have, address shortages and forecast future needs, many boards quantify and record their directors' skills and experience in a 'skills matrix.'

A skills matrix is a document that profiles its directors' skills and experience. There are several ways that this can be presented, including which skills are highlighted within the matrix. Boards should consider what skills and experience are relevant to them in the context of their purpose and strategy.

The example simple skills matrix below demonstrates how three fictional board members have been assessed against a set of general criteria. Some more detailed matrices will ask directors to assess their proficiency within the set criteria.

Figure 3: Example board skills matrix

	Accounting	Investment	Legal	Human Resources	Technology	Marketing	Fundraising	Industry	Governance	Media	Risk	Government
Amrita Chandra	✓	✓		✓	✓		✓				✓	
Jose Garcia			✓					✓	✓			✓
Rashia Abdi				✓	✓	✓	✓		✓		✓	

While technical skills are important, boards should look beyond these to consider the other attributes of directors such as a passion for the organisation's purpose and soft skills such as communication, negotiation and conflict resolution. One of the more challenging balances to strike is in having diverse perspectives and encouraging robust debate while maintaining a respectful and cohesive working relationship between directors. The absence of a collegiate approach to decision-making can lead to dysfunction and decision paralysis.

It is a good idea for boards to disclose their members' skills and experience to stakeholders to help them understand who is responsible for governing the organisation. Although some boards may disclose a full skill matrix as in the example of Figure 3, NFPs will also provide this information in an anonymous way. For example, through recording how many directors have a certain skill without disclosing which particular directors have this skill.

The skills matrix can also be a useful way to identify areas for board training, development and succession planning.

Size of the board

Boards need to have enough members to fulfil their responsibilities, access the skills and experience they need, and to facilitate changes to composition without major disruption. However, if the board is too large it may be difficult for all directors to contribute and this may undermine its effectiveness.

Boards must determine for themselves, within the limits imposed on them by their governing documents and the law, what the ideal board size is for their circumstances. Generally, NFP boards tend to be between six and 11 people, though they may be smaller or larger.

An organisation's governing documents and any laws that apply to it may set out requirements about the minimum and maximum number of directors a board may have. There may also be requirements about how many directors must be present at a meeting for it to be valid (quorum).

Succession planning

Succession planning refers to taking a methodical approach to projecting the future skill and experience needs of the organisation, and putting plans in place to meet them. Boards should forecast when vacancies will arise and identify suitable candidates to facilitate smooth transitions between directors.

It is important that a board is prepared to respond to and meet the gaps created by the natural rotation of directors, or more unexpected events such as sudden illness or death. Boards should engage in succession planning not only for directors, but also for the CEO and other senior staff. This is not always a precise activity, and so boards should be prepared to be flexible in their approach.

One way this can be done is through maintaining a list of suitable and interested candidates to create a pipeline of prospective directors that can be drawn on in response to need. Some boards use more structured programs such as allowing prospective directors to be 'observers', so they can learn about the board's business (without participating in decision-making) and be better prepared when a vacancy arises. It is also common for boards to appoint people to committees with a view to preparing them to become directors in the future.

It may be helpful to get advice from a recruitment consultant to deepen the talent pool of potential new directors.

Board diversity

One of the benefits of having a board is that it brings several minds to focus on a shared purpose. This benefit is multiplied when directors bring diverse perspectives to bear on their work, making available different ways of processing information and solving problems.

Governance is a team sport, and as with any sports team it is the quality of the team overall (and not any individual member) that defines its success.

The arguments for the importance of board diversity have their roots in social justice, drawing on principles of equality and fairness. However, research demonstrates that diversity on the board can contribute to improved performance. Diverse boards have also been shown to increase staff retention and engagement, promote a better understanding of an organisation's stakeholders and drive innovation. Diversity also assists in deepening the talent pool from which to draw staff, executives and directors.

Boards should aim to reflect a mix of personal attributes in their composition. This may include:

- Gender;

- Cultural and linguistic background;

- Professional experience;

- Sexuality;

- Attitudes;

- Age;

- Educational qualification;

- Lived experience;

- Technical skills;

- Socioeconomic background;

- Marital or family status;

- Boardroom behaviours;

- Religious belief; and

- Gender identity.

Research has shown that it is not only the diversity of personal attributes which influence a board's performance but also diversity in thinking style. This is referred to as 'cognitive diversity.'

Diverse boards also send an important message about the values of an organisation and the society it wishes to create. There has been a significant focus on the representation of women on boards for many years which recognises the imbalance of female participation in the workforce, particularly in senior roles. Much progress has been made in this regard, but there is also increasing focus on other aspects of diversity, such as the under representation of people from culturally and linguistically diverse backgrounds.

Achieving board diversity

Diversity can be a challenging goal for organisations to achieve. For many NFPs, simply finding someone who is willing to serve as a director can be challenging enough, let alone representing multiple diverse attributes in a small cohort of people. This difficulty can be compounded for organisations whose directors are appointed by election where the board may have limited opportunity to influence its composition.

One way through which boards can aim to achieve diversity is through establishing a diversity policy. This is a policy that both expresses the organisation's commitment to achieving diversity and outlines the practical measures the organisation will take to achieve diversity. For example, a diversity policy might:

- Set targets for the representation of certain personal attributes (such as gender) on the board or in the staff cohort, and measure and publicly report on performance against these targets;

- Commit to inclusive and flexible employment practices such as providing reasonable adjustments to physical work environments for people living with disability, and providing flexible working arrangements to support different lifestyle needs;

· Support programs that encourage and celebrate diversity such as cultural awareness training and networks for lesbian, gay, transgender and intersex people and their allies; and

· Require that recruitment practices are inclusive to guard against conscious and unconscious bias in selection processes.

Setting performance targets around diversity is important because what gets measured gets done. For example, many boards in the private sector have committed to ensuring at least 30 per cent of their board are women because this number has been shown to be the 'tipping point' after which diversity will usually become entrenched in an organisation's culture.

"Setting performance targets around diversity is important because what gets measured gets done.."

QUESTIONS FOR DIRECTORS

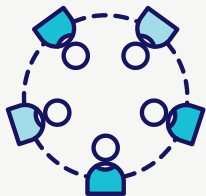**IS THE PROCESS FOR APPOINTING DIRECTORS CLEARLY DEFINED, TRANSPARENT AND FOLLOWED?**

WHAT IS THE BOARD'S CURRENT SKILLS MIX, AND HOW IS IT COMMUNICATED TO STAKEHOLDERS?

WHO WILL BE LEAVING THIS BOARD IN THE NEAR-TERM FUTURE AND IS THERE A PLAN TO RESPOND?

WHAT SKILLS WILL THE BOARD NEED IN THE FUTURE AND HOW WILL THEY BE ACCESSED?

WHAT STEPS HAS THE BOARD TAKEN TO PROMOTE DIVERSITY?

CASE STUDIES

HelpfulCare

HelpfulCare has six directors. Each director is appointed for a three-year period. The appointments are staggered so that there are never more than two members departing the board at any one time (unless they depart for other reasons, including resignation). The constitution allows the appointment of members to casual vacancies. The board has a composition policy which they use to assist them in making decisions to appoint directors.

The composition policy sets out the skills and experience it is seeking from its directors. The board reports its directors' skills against five key dimensions:

- Sector knowledge;
- Strategy and risk;
- People, culture and conduct;
- Financial acumen; and
- Regulation and governance.

The number of directors with each skillset is communicated through the annual report. The board has also set a quota of having 40 per cent women on its board, and its performance in this regard is also communicated in the annual report.

HelpfulCare's board review their composition annually and consider this in the context of succession planning. The board's nominations committee is charged with identifying and developing relationships with suitable candidates for board roles consistent with the requirements of the composition policy.

The Friendlies

The nine directors of the Friendlies are elected by the membership at their annual general meeting. Directors are elected for a two-year period. The Friendlies' constitution sets out how elections are to be held, including if directors can be reappointed after their two-year term. The relevant parts of the constitution are circulated to members in advance of the annual general meeting.

The Friendlies communicate their directors' skills and experience by including profiles of them in their annual report. The board maintains a skills matrix but this isn't disclosed to stakeholders. At the annual general meeting, the president makes a statement (approved by the board) about the skills gaps they are seeking to address. At the meeting, those nominating for a position are allowed the time to address the members about how their skills and experience would benefit the organisation.

At the discretion of the president, members are permitted to attend for non-confidential parts of a few board meetings to act as 'observers'. The immediate past president has a special role set out in the constitution which enables them to continue on the board for one year in order to provide continuity, and to take a mentoring role with new members, at the board's discretion.

PRINCIPLE 4

PRINCIPLE 4

Board effectiveness

The board is run effectively and its performance
is periodically evaluated

4.1   Board meetings are chaired effectively and provide opportunity for all
        directors to contribute

4.2   Directors seek and are provided with the information they need to fulfil
        their responsibilities

4.3   Directors are appropriately inducted and undertake ongoing education to
        fulfil their responsibilities

4.4   The board's performance, as well as the performance of its chair and other
        directors, is periodically evaluated

4.5   The relationship between the board and management is effective

For a board to be effective it must take a thoughtful, disciplined and professional approach to its work. This can be done through careful forward planning of board business, efficient operation of board meetings, regular performance assessments and effective chair arrangements. This is true not only for the board, but also for its committees.

Board agendas

An agenda is a document that sets out what business will be considered at a meeting. It lists the matters being addressed, the order in which they will be discussed and how much time is allocated for each. Agendas help directors to prepare for meetings and align their focus to the work of the board. They also assist the chair in ensuring that issues are dealt with in an appropriate order and depth during the meeting.

Board agendas are usually prepared by the chair with the assistance from the CEO or company secretary. It is a good idea for the chair to invite directors to contribute to the formulation of the agenda, however, generally the chair has final say on the agenda. That said, directors should always have opportunity to raise issues for the attention of the board at meetings. This is usually done through a standing agenda item of 'other business.'

Effective agendas will specify the expected outcome of each item before the board. The agenda should indicate whether each item is for decision, for discussion, to be noted or presented as information only. It is helpful if agendas indicate this as some matters cannot be deferred and directors should come prepared to act.

Board meetings

For the most part, the work of a board is conducted through meetings. Boards can only exercise their authority as a group, and so meetings provide the opportunity for directors to gather, deliberate and exercise their authority.

How meetings happen will vary between organisations. Within any limits set by the law and by their governing documents, boards can generally determine for themselves how they meet including with what frequency, by what method (in person or electronically) and at what time.

An organisation's governing documents and any laws that apply to it may set out requirements about how meetings are held. For example, there may be requirements about:

- When and how directors must be notified of a board meeting;
- How many directors must be present for a meeting to be valid (quorum);
- Whether meetings must be held in person or electronically;
- How decisions are made at meetings (for example, by poll or by show of hands);
- How decisions can be made without a board meeting (usually in writing following a particular process, which may be necessary for urgent matters);
- How many meetings must be held in a year; and
- Any minimum attendance requirements for directors

It is a good idea for the requirements around how a board conducts its meetings to be set out in a policy document.

> **!** *Many laws now are 'technology neutral' meaning that they do not specify or require the use of a particular technology. However, it is a good idea to check your governing documents and any laws that apply to your organisation about how meetings must be held.*

Making decisions

The most important function of a board meeting is to make decisions. This is how the board exercises its authority.

An organisation's governing documents and any laws that apply to it may set out requirements about how decisions must be made. For example, under the Corporations Act, decisions can only be made when supported by a majority of directors unless otherwise specified in an organisation's governing documents.

Many boards, particularly NFP boards, aim to make decisions by consensus (by general agreement). This means that through discussion a board aims to make a decision that has the broad support of most, if not all, directors. However, once a decision has been made, all directors (even those who may not have agreed with the decision) will be held responsible for it.

Board minutes

Board minutes are used to record the activities and decisions of a board. They are not a transcript of every word that was said during a meeting or a record of directors' individual contributions.

! *An organisation's governing documents and any laws that apply to it may set out requirements about how minutes must be recorded, for how long they must be stored and to whom they must be made available.*

If possible, it is a good idea for the minutes to be taken by someone who is not participating in the meeting so that those people participating can focus on the meeting. Often the minutes will be taken by the company secretary. The person who takes the minutes should be someone who is trusted to hear confidential information about the board's business.

The board should approve the minutes of each meeting to confirm that they are an accurate record of their work. It is a good idea for draft minutes to be circulated to the board soon after a meeting while the business of the meeting is still fresh in directors' minds and then approved before or at the next meeting.

The amount of detail included in the minutes will vary between organisations. Generally, minutes will include matters such as:

· What meeting was held, where and when;

· The names of attendees and any apologies;

· Any conflicts of interest declared;

· Matters discussed at the meeting; and

· Any decisions made by the board.

Minutes are one way that a board can demonstrate its accountability for its decisions. For significant decisions, it is a good idea to briefly outline any factors that were considered in decision and the amount of time allocated for discussion. This can help to establish that directors have exercised proper care and diligence in the exercise of their authority.

It is important to note that minutes can be used as evidence in legal proceedings and as such it is important to take care in the preparation of board minutes.

Board papers

Directors are responsible for ensuring they have access to the information they need to make their decisions. This is part of their duty to act with care in diligence which is discussed in greater detail in *Principle 2: Roles and responsibilities*. One of the ways they do this is through requesting and receiving information in the form of board papers.

Board papers are usually prepared by people who are not directors, but who understand the board's needs such as the CEO or company secretary. Information in board papers should be consistent, coherent and complete. Board papers are part of the official records of the company and should be maintained in accordance with any requirements regarding recordkeeping that may be set out in an organisation's governing documents or under the law.

It is the responsibility of directors to read and understand the information contained in board papers. If directors feel they need more information to perform their roles, it is their responsibility to seek it out. To do this, it may be necessary to consult with an organisation's staff and directors should do this by working with and through the CEO.

*"The more things that you read, the more things you will know.
The more that you learn, the more places you'll go."*
Dr Seuss

In some circumstances, directors may also need to access the independent advice of external experts such as legal practitioners, for example in relation to the exercise of their legal duties.

Planning board business

A well-planned meeting schedule helps identify the key issues for the board's attention and helps directors address issues in a timely and logical manner.

Many organisations use a 'board calendar' which assigns important and recurring governance matters to scheduled meetings in a single document. Board calendars help directors to govern effectively by aligning the focus of the board to its priorities and obligations for the year. Board calendars can also help prevent items from being overlooked and assist directors to take a more long-term view of their work.

One way to develop a board calendar is to list the key issues that a board will need to consider throughout the year and allocate them to a particular meeting. The example below demonstrates how this can be done with regard to the board's focus on finance matters.

Figure 4: Example board calendar – finance matters

	J	F	M	A	M	J	J	A	S	O	N	D
Finance												
Budget review and approval					✓							
Review of annual financial report								✓				
Management accounts review	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Investment strategy review		✓							✓			

Inducting board members

Directors have all the responsibilities that come with their roles from the moment they are appointed. As such, it is important that they are prepared to fulfil their responsibilities. A thorough induction process can assist with this.

It is a good idea for new directors to receive a letter of appointment that sets out what their responsibilities are and any other information relevant to their appointment. This letter should also outline the process for induction.

The induction process should be tailored to reflect the circumstances of the organisation as well as the skills and experience of the new director. Generally, induction processes will include:

- Providing information such as the governing documents, board charter, the strategic plan, recent board papers and minutes, board policy handbook, and the board calendar;

- Introduction to key individuals including the CEO and senior staff, the chair and other board directors;

- Establishing a mentoring relationship with a more experienced director; and

- Providing briefing and training to familiarise new directors with the organisation and their responsibilities as directors, including regarding key organisational risks.

After a board member has been inducted, seeking their feedback about the process is a good way to identify any additional learning needs, and to improve the process for future inductees.

Chairing board meetings

The role of the chair is critical in supporting effective meetings. Outside the boardroom, the chair plays an important role in setting the board's agenda and in ensuring that board members have access to the information they need to fulfil their responsibilities. Inside the boardroom the chair facilitates discussion so that all agenda items are dealt with appropriately.

The chair also plays an important role in setting the tone for the board and aligning discussions to the organisation's purpose. Board meetings should be collegiate, and the chair facilitates this by setting the example of behaviour and by providing clarity of purpose to decision-making. The chair should provide opportunity for all directors to be heard, and facilitate and enforce respectful conduct between directors.

Board-management relations

An effective relationship between the board and management contributes significantly to the effective operation of the organisation. Although management reports to the board, it is important that the relationship between the two is based on mutual trust and respect.

Management and the board must work together as a team to achieve the organisation's purpose. For this relationship to be effective, each must understand and respect the role of the other. Directors must be prepared to seek and accept management's advice, but to do so in a way that is constructively critical and challenging without undermining trust or being unduly interfering.

This can be a challenging dynamic and while it is a good idea to record how this relationship is managed in a policy document such as a board charter, its impact is felt in the translation of these principles into practice in the boardroom.

Because directors do not have individual executive authority within an organisation, their interactions with management should generally be channelled through the chair and CEO. It is not the role of individual directors to supervise or direct the work of staff or volunteers. It is a good idea for board members to keep the CEO informed about any relevant interactions they have with management as a courtesy.

Chair–CEO relations

The relationship between the chair and the CEO is critical to the effective operation of the board and, by extension, the organisation. The chair represents the board to the CEO and acts as a conduit for communication between the board and CEO between board meetings.

It is a good idea for the chair and the CEO to meet on a regular basis outside board meetings to develop this relationship and to provide opportunity for frank and open discussions. Often the chair will act as a mentor and sounding board for the CEO, working closely together to align the activities of board and management.

The chair will also generally take responsibility for leading the process around CEO remuneration, performance and succession planning. It is also common for the chair to lead the process for CEO appointment and, if necessary, disciplinary action or dismissal.

"Management and the board must work together as a team to achieve the organisation's purpose. For this relationship to be effective, each must understand and respect the role of the other."

Reviewing the performance of the board

The board should work to continuously improve the way it fulfils its responsibilities. To enable this, it is common for boards to undertake formal performance reviews which help to identify gaps in the governance framework and opportunities to develop. The aim of this exercise is to evaluate the effectiveness of the board and may include a focus on the board, its committees, individual directors, the chair or a combination of these.

How an evaluation is done and with what frequency is a matter for the board to consider, but it is a good idea to have a formal process that outlines how these are to be undertaken. Board evaluations may be done either internally or by use of an external consultant. It is common for boards to undertake an internally-managed board review on an annual basis and an externally facilitated review every few years.

The chair generally has responsibility for overseeing the process of board evaluation, often with the assistance of a committee.

QUESTIONS FOR DIRECTORS

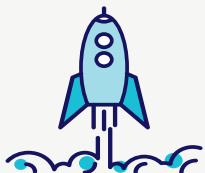**HOW WELL PREPARED ARE NEW DIRECTORS TO TAKE ON THEIR RESPONSIBILITIES?**

DO DIRECTORS HAVE ACCESS TO THE INFORMATION THEY NEED TO MAKE INFORMED DECISIONS?

IS THERE A TONE OF RESPECT AND COLLEGIALITY IN BOARD MEETINGS?

DO DIRECTORS UNDERSTAND THE DELINEATION BETWEEN THE ROLES OF BOARD AND MANAGEMENT?

WHAT STEPS IS THE BOARD TAKING, OR SHOULD THE BOARD BE TAKING, TO IMPROVE ITS PERFORMANCE?

CASE STUDIES

HelpfulCare

The chair of HelpfulCare is elected every year by the board following the annual general meeting. Their appointment is at the discretion of the board.

The nominations committee oversees a formal induction process for new directors. This involves a dedicated training program accompanied by specific information about the organisation's governance such as the constitution and board handbook. As part of this process, directors meet with the chair and the CEO, and are provided with opportunities for further meetings as required.

The board has a budget for learning and development and all directors are required to assess their training needs every year and undertake any identified training with the approval of the board.

The board engages an external consultant to undertake an annual board review and its individual directors, and the chair receive 360-degree appraisals every two years. This process provides management with the opportunity to provide feedback about the board, which is reviewed by the governance committee and summarised for the board with reccomendations for development.

The chair meets regularly with the CEO and works closely with them on the development of the agenda and board papers. Board papers must be approved by the chair before they are circulated to directors. They must be circulated two weeks prior to a scheduled meeting. The board meets eight times a year for a half day meeting.

The Friendlies

The president of the Friendlies is directly elected by the members every two years. The immediate past president remains a member of the Friendlies' board for one year to support the incoming chair and to mentor new directors at the board's discretion.

New directors are provided with relevant governance policies as well as copies of recent board papers. Every second meeting a board member prepares and presents on a topic relevant to the meeting as part of a self-directed training program, and every two years the board receives a formal refresher session on their directors' duties from a community legal service.

Every two years the board establishes an ad hoc committee to undertake a board review. They design and deliver a survey and report the results to board members. As part of the review they ask questions about the performance of the chair, and individual directors are given the opportunity to self-evaluate and compare this evaluation against their peers in an anonymous way.

The chair and the coordinator meet regularly and always in the week before the board meeting to develop the agenda and to review any reports that go to the board. Directors often contribute to the development of board papers.

PRINCIPLE 5

PRINCIPLE 5

Risk management

Board decision-making is informed by an understanding
of risk and how it is managed

5.1   The board oversees a risk management framework that aligns to the
       purpose and strategy

5.2   Directors seek and are provided with information about risk and how it is
       managed

5.3   The board periodically reviews the risk management framework

Risk is inherent in all human endeavours – including in the activities of organisations. The role of the board is to understand the organisation's risk, to make decisions based on this understanding and to oversee a framework that manages risk on an ongoing basis. Risk is not something to be avoided, but to be understood and leveraged in pursuit of an organisation's purpose.

"The best laid schemes of mice and men
Go often awry."

Robert Burns, To a Mouse, 1785

What is risk?

The International Organisation for Standardisation (ISO) defines risk as "the effect of uncertainty on objectives" (*AS/NZS ISO 3100 Risk management*). This is a useful definition as it helps to explain why risk is important to governance – it must be understood and considered in decision-making so that the organisation achieves its purpose with an acceptable degree of certainty.

Importantly, risk is not inherently bad. It arises because the future is unknowable and therefore the outcomes of decisions are always uncertain to some extent.

Risk is typically characterised by considering examples of events that could occur, their likelihood and the consequence of their impact. These examples are colloquially called 'risks'. For example, hypothetical risks could be that a building burns down or that a funding contract is not renewed. It is important to note that these are only illustrations that help to understand risk and are only relevant in the context of the making of a particular decision.

It is easy to confuse these example 'risks' with 'risk.' Risk refers to the uncertainty that is inherent in all decisions because they must be made on the basis of certain assumptions.

All decisions are based on assumptions about:

- Internal factors (such as structure, staff skills and resource availability);
- External factors (such as the regulatory environment, funding availability, interest rates); and

- Wider factors (such as political changes, public sentiment about donations, or climate change).

What is a risk management framework?

The way that organisations take uncertainty into account when they make decisions is called 'risk management.' The goal of risk management is to increase the certainty that a decision's intended outcome will be achieved. It involves the identification, evaluation and prioritisation of risks.

Risk management should not be considered as a discrete activity. Rather, it should be embedded in the practices, processes and policies within an organisation that are concerned with making decisions and ensuring that these decisions continue to be valid.

Risk management happens in all organisations because people consider, to some extent, what they need to do to make sure their decisions achieve their intended outcome. This approach may be ad hoc and inconsistent across the organisation, but it is always happening.

However, organisations can adopt more formal processes to facilitate better management of risk. This is called developing a risk management framework.

The Australian/New Zealand Standard on Risk management defines a risk management framework as:

> **AS/NZS ISO 31000:2009 RISK MANAGEMENT – PRINCIPLES AND GUIDANCE**
>
> A risk management framework is a set of components that provide the foundations and organisational arrangements for designing, implementing, monitoring, reviewing and continually improving risk management throughout the organisation.

There is no one-size-fits-all approach to developing a risk management framework. Large organisations may have highly-developed approaches, systems and processes which are supported by both internal and external professional advisers. Smaller organisations facing simpler decisions may adopt more informal approaches, relying on their own experience, judgement and common sense to manage risk.

Benefits of risk management

The purpose of risk management is to support more informed decision-making. When a decision is made based on an understanding of risk and how it is managed, the chances that it will contribute to achieving the

organisation's purpose will improve. Ultimately, risk management aims to increase the certainty that an organisation's purpose will be achieved.

Risk management enables the organisation to:

- Challenge assumptions in decision-making;

- Take actions that will increase the likelihood that a desired outcome will be achieved;

- Identify early signs that an undesirable event may occur and take pre-emptive action to address it;

- Learn from successes and failures in a way that improves decision-making over time; and

- Consider whether previous decisions remain valid and, if necessary, revise them.

The board's role in risk management

The board's role is to oversee a framework that manages risk as an integral part of the decision-making process both at the board level and throughout the organisation.

Risk management is not a separate activity of the board. While the board may contribute to identifying risks, it can be a distraction for boards to spend time reviewing lists of hypothetical risks and the steps that might be taken to prevent them.

When the board makes a decision, they should ask management what actions they will take so that the intended outcomes of the decision will be achieved with an acceptable level of certainty. The steps taken by management to identify and control the uncertain elements of implementation is part of risk management. Boards should be satisfied that these steps are sufficient and in alignment with their expectations.

The board should also monitor the outcomes of decisions they make. Where the context for decisions changes or the assumptions on which they are made become invalid, the board may seek to alter these decisions or take new actions so that the desired outcomes remain sufficiently certain.

Reviewing the risk management framework

The board should periodically review how well the organisation is managing risk as part of decision-making. This should involve reviewing the risk management framework that enables this to occur.

How a review is undertaken, by whom and with what frequency will depend on the nature of the organisation and its circumstances. For example, if an organisation has been subject to significant change, it may require a more thorough or frequent review of its risk management framework.

In undertaking a review of the risk management framework, directors should ask:

?	*Is there clarity about how risk is managed in the organisation?*
?	*Is the risk management framework appropriate for the decisions the organisation faces?*
?	*How effectively has risk management been applied to past decisions?*

Responding to risk

It is important to note that the purpose of risk management is not to minimise or eliminate risk. This approach can seriously undermine an organisation's ability to achieve its purpose. There are several different approaches an organisation can take in responding to risk:

- Avoidance – an organisation can avoid risks by discontinuing the activity that generates the risk;

- Treatment – taking steps to control either the likelihood, or the consequence of the risk if it occurs;

- Transference – passing the risk on to another party such as outsourcing the activity or acquiring insurance; and

- Acceptance – accepting that a risk may eventuate and putting plans in place to respond if does.

Risk appetite

One of the most important roles of the board in risk management is in developing an understanding about the nature and the extent of risk the organisation is prepared to accept in pursuit of its purpose. This is often called defining a 'risk appetite.' The risk appetite provides parameters within which management can pursue the organisation's purpose.

It is critical that the organisation's risk appetite is aligned with its purpose. If an organisation is not prepared to accept enough risk, it may be inefficient in pursuing its purpose; if it accepts too much risk it may be exposed to undesirable consequences that undermine its performance.

Defining and documenting the organisation's appetite for risk supports the development of an appropriate risk culture which aligns to and supports the purpose and strategy. Boards must be careful that they are not so concerned with negative risk that opportunities are missed, but they can also not have such a disregard for risk as to expose the organisation to serious harm. Striking an effective balance between the two is the hallmark of a sound risk appetite. The board's role in culture is discussed in greater detail in *Principle 10: Culture*.

Risk management committee

Many organisations will establish a committee to assist the board in exercising due care, diligence and skill in relation to risk management. In smaller organisations it is common for the risk management committee to be combined with other committee functions such as the audit committee.

Objectives for a risk management committee may include:

- Advising the board on the effectiveness of the risk management framework;

- Supporting provision of accurate, relevant and timely information about risk;

- Examining previous decisions to see how risk was managed as part of making those decisions;

- Monitoring and reviewing safety systems throughout the organisation;

- Oversight of insurance programs to maintain appropriate coverage;

- Monitoring the organisation's business continuity processes; and

- Developing and maintaining an appropriate risk culture that is embedded through the organisation.

In larger and more complex organisations, staff involved in the management of risk may also be involved with or have reporting lines to the risk management committee.

"Boards must be careful that they are not so concerned with negative risk that opportunities are missed, but they can also not have such a disregard for risk as to expose the organisation to serious harm. Striking an effective balance between the two is the hallmark of a sound risk appetite."

QUESTIONS FOR DIRECTORS

IS THE BOARD AWARE OF HOW RISK IS MANAGED IN THE ORGANISATION?

IS THERE A SHARED UNDERSTANDING OF THE ORGANISATION'S RISK APPETITE?

HOW OFTEN SHOULD THE BOARD UNDERTAKE A REVIEW OF THE RISK MANAGEMENT FRAMEWORK?

IS THE RISK MANAGEMENT FRAMEWORK ALIGNED TO THE ORGANISATION'S PURPOSE?

DOES THE BOARD HAVE ACCESS TO EXTERNAL PROFESSIONAL ADVICE ON RISK MANAGEMENT?

CASE STUDIES

HelpfulCare

In making or reviewing decisions, the board of HelpfulCare regularly questions management about how risk has been understood and responded to. The consideration of uncertainty is part of its formal decision-making processes.

The board has also established a risk management committee whose purpose is to assist the board with its oversight responsibility. The risk management committee reviews decisions made by the board to consider whether risk has been properly considered, and there is a sufficient degree of certainty of achieving the desired outcome.

At their annual strategy day, the board and management test the objectives of the strategic plan to understand the uncertainties that could affect the achievement of their goals. If there is not sufficient certainty, objectives are adjusted to make their outcomes more certain or other, ancillary actions agreed upon (to help increase the level of certainty).

The board of HelpfulCare engage the services of external consultants to undertake an annual review of their framework for managing risk. The risk management committee works with the consultants to agree actions that should be taken to enhance the effectiveness of risk management in the organisation.

The Friendlies

The Friendlies manage risk as an integral part of decision-making. Their directors examine the assumptions involved about uncertainty in the internal and external environment as part of their decision-making process.

The board works to make sure that their decisions remain relevant and that the desired outcomes continue to be sufficiently certain. To do this they receive and consider reports on:

- Whether the implementation of their decisions proceeded as intended;

- Whether any ancillary actions were also properly implemented; and

- Whether changes in the operational context have affected or could affect the outcome of their decisions.

In response to these reports, the board sometimes adjusts their decisions or authorises ancillary action to make sure their goals are achieved with sufficient certainty.

Every two years an ad hoc committee of the board of the Friendlies formally reviews how risk has been managed as part of past decision-making. Where there is adequate documentation past decisions are examined using the criteria above.

PRINCIPLE 6

PRINCIPLE 6

Performance

The organisation uses its resources appropriately
and evaluates its performance

6.1   The board oversees appropriate use of the organisation's resources

6.2   The board approves an annual budget for the organisation

6.3   The board receives and considers measures which evaluate performance
against the strategy

6.4   The board oversees the performance of the CEO

6.5   The board monitors the solvency of the organisation

For an organisation to pursue its purpose it must set clear goals and timeframes within which they are to be achieved and measure its progress in achieving them. The board must work with organisation's staff, if any, to identify these goals, make resources available to achieve them and oversee the appropriate use of these resources.

Oversight of resources

Resources are the tools that organisations use to achieve their goals. Resources can generally be grouped under four categories:

- Financial (such as cash reserves, credit and investments);

- Physical (such as real estate, equipment and vehicles);

- Human (such as employees, volunteers and their skills); and

- Intellectual (such as copyrights, brands and data).

Directors have an important role to play in overseeing the proper use of these resources. The board must understand what resources the organisation has access to and make them available, with appropriate controls, for the achievement of the organisation's goals.

> **!** *NFPs have a special obligation under the law to only apply their resources for their purpose and not for the private benefit of the people involved with the organisation.*

It is common for boards to oversee the development of policies that set out how resources must be properly used and maintained. For example, most boards will establish a policy about who can spend the organisation's financial resources and under what circumstances they can be spent. It is common for organisations to establish policies concerning appropriate use of technology, management of intellectual property and human resources.

Beyond focusing on the appropriate use of resources, boards should also consider whether resources are being used efficiently. One of the key ways the board does this is through defining performance targets, often called key performance indicators (KPIs). These targets help the board to monitor progress against defined measures, which should be aligned to the organisation's goals.

Budgeting

Budgeting is an important annual process that helps organisations to identify and plan for future needs, and to allocate resources accordingly. Budgets generally last for a 12-month period and are focused on forecasting revenue and expenses, though may include consideration of other resources and measures. It is common for management to develop the budget and for this to be approved by the board, but boards may take a more active role in this process in some circumstances.

The purpose of the budget is to align an organisation's resources to its goals and to set parameters around how resources will be used across a year. For example, the board may authorise management to spend the organisation's financial resources within the budget but may require approval for any expenditure outside the approved allocations or above a certain amount.

Boards will generally review the organisation's performance against its budget at regular intervals using 'management accounts.' These are internal documents that track performance against the budget.

Measuring performance

For an organisation to know what it is doing and how its activities contribute to achieving its purpose, it must define and evaluate its performance against defined measures. There are a wide range of performance measures that are used across the NFP sector. Boards should select a mix of both financial and non-financial performance measures to help it develop a more complete picture of the organisation's performance.

Generally, performance measures should be:

- Meaningful to the organisation;

- Capable of being measured and acted upon;

- Timely;

- Cost effective to produce;

- Comparable; and

- Simple (where possible).

One of the ways the board can align the work of the organisation to its purpose is through defining performance measures that support the organisation's purpose. Defining and overseeing these measures enables the board to develop accountability – both in its reporting to external stakeholders and in holding management to account. This is discussed in greater detail in *Principle 7: Transparency and Accountability*.

Performance of the CEO

As part of providing oversight of the CEO, the board should define and evaluate performance measures for the CEO which are aligned to the organisation's purpose and the strategy. This way the board can keep the CEO accountable for their performance. Generally, the CEO will use their own performance measures to inform the measures for other staff. This helps align the activities of everyone involved in the organisation with the purpose.

Boards should be careful in the development of these performance measures. People will naturally orient themselves to work towards meeting their performance targets (especially if there is an incentive for doing so) and so the form these measures take can significantly influence the way that the people in the organisation behave. This is discussed in greater detail in *Principle 10: Culture*.

The board should provide regular and honest feedback to the CEO on performance including the board's expectations. The CEO also has a responsibility to keep the board informed about progress against performance measures by providing regular reports. This will help the board form an opinion about the CEO's performance and inform the feedback they provide.

Financial information

Directors are required to read and understand financial information so they can play their part in monitoring the organisation's financial health and performance. This is part of the duty of directors to act with care and diligence which is discussed in greater detail in *Principle 2: Roles and responsibilities*.

Importantly, every director has a responsibility to understand the organisation's finances and to contribute to appropriate financial oversight. This is not the sole remit of the treasurer, nor can this responsibility be outsourced to an organisation's accountants or external advisers.

The board should work with management to determine how best to communicate information about the organisation's financial position. Information produced for this purpose is referred to as 'management accounts.'

Management accounts usually include the following three types of financial statements:

Figure 5: Types of financial statements

Balance sheet	This statement shows the organisation's assets (the things the organisation owns such as cash and property), liabilities (the things the organisation owes such as debts and provisions) and equity (the organisation's net worth) at a point in time.
Statement of profit and loss	This statement shows how much money an entity has earnt during the period, generally on monthly or yearly terms. The statement shows revenue minus expenses, revealing the profit and loss for the period.
Cash flow statement	This statement shows the movement of cash in and out of the organisation under categories of operating, investing and financing activities to show a net change in cash for the period.

! *Where a financial report is presented to members and other stakeholders, laws and regulations may require them to be presented in accordance with Australian Accounting Standards.*

The numbers in these statements are intrinsically linked. Organisations can make use of accounting software that links the data in these statements to provide greater integrity in financial reporting, but directors should carefully review whether these statements are correct.

Together, these three financial reports present the overall picture of the organisation's financial health at a point in time.

Financial health

Evaluating the organisation's financial health is an important part of the role of the board.

In doing so, the board must identify what the financial goals of the organisation are. This includes determining matters such as the required level of reserves, an appropriate diversity of revenue streams and the right asset mix to maintain. Boards will generally look closely at their budget, management accounts and financial reports to evaluate performance against these goals.

There are several standard indicators that organisations can use to assess financial performance:

Figure 6: Examples of financial performance measures

Performance category	Possible indicators
Program efficiency	Ratio of program expenses to program commitment
	Ratio of program expenses to total expenses
Fundraising efficiency	Ratio of fundraising expenses to funds obtained
	Ratio of fundraising to total expenses
Grant efficiency	Ratio of grant submissions to grants obtained
	Ratio of grants to total expenses
General financial indicators	Revenue growth
	Working capital ratio
	Return on equity
	Return on assets

> **!** *Being an NFP does not mean that you cannot make a profit (sometimes called a 'surplus'). NFPs can make a profit provided it is used to further its purpose.*

There is a perception among some NFPs that they should not set and achieve ambitious profit goals because this may be viewed poorly by stakeholders. However, aiming to achieve long-term financial sustainability should be a core goal of all organisations so that they can achieve their purpose now and into the future. This involves making smart financial decisions and aiming not only to get by, but to build and maintain financial strength.

"Profit is not a dirty word."

Susan Pascoe AM FAICD
Inaugural Commissioner of the Australian Charities and Not-for-profits Commission. Launch of the 2017 AICD NFP Governance and Performance Study

While it is important to plan for financial strength, NFPs should not pursue profit at the expense of delivering their purpose or be perceived to be doing so by stakeholders. Boards play an important role in determining a financial vision for the organisation and communicating it to stakeholders.

For example, if an NFP is seeking donations while at the same time making a large profit so that it can pay for a new piece of equipment, it is important that this is understood by stakeholders. The board should make sure that the intention of their financial decisions is communicated to members so that they can understand how the organisation's resources are being used to further the organisation's purpose.

This also applies to an organisation's reserves. Having adequate reserves is important to support financial health and can play an important role in managing risk. Determining the right level of reserves is a matter for the board and should include consideration of the organisation's operational context (such as its operations, staffing, funding landscape, liabilities and the external market) to help assess current and future financial needs.

It is important that the board takes a considered approach to the management of its reserves. It is a good idea to develop a policy that sets out the board's intentions around the maintenance and use of reserves. This policy can also help the board to communicate with stakeholders about how they are managing the organisation's financial resources.

Monitoring solvency

Solvency refers to an organisation's ability to pay its debts as and when they are due. This means that an organisation must have access to enough cash (or assets that can be quickly converted to cash) to pay for any debts it may have. Monitoring solvency is a key responsibility of each director.

One of the ways a board can do this is by monitoring the organisation's cash flow. If more money is consistently going out than is coming in, this may be an indication that the organisation is heading towards insolvency. Estimating future cash flow needs and monitoring the working capital ratio (which shows the relative proportion of the organisation's current assets to its current liabilities) can also provide insight into an organisation's solvency. It is generally considered good practice for an NFP to have a working capital ratio of 1.5 or greater, meaning that current assets should be 1.5 times greater than current liabilities. Where this is not the case, this should be prompt inquiries from directors.

> **!** *Most organisations will be subject to legal requirements about being and remaining solvent. Directors may be personally liable for any debts incurred if an organisation continues to trade after it becomes insolvent.*

Faced with the prospect of insolvency, many boards choose to shut up shop and call in an administrator or liquidator. However, directors may be able to rely on a 'safe harbour' defence if they begin a course of action that is reasonably likely to lead to a better outcome for the organisation than the appointment of an administrator or liquidator.

Insolvency is a complex and serious issue, and directors should take swift action if they are concerned that the organisation is, or may become, insolvent. Often this will include seeking expert, professional advice.

Non-financial performance

The performance of an NFP should not be evaluated in financial terms alone. To build a complete picture of an NFP's performance, it is also important to use non-financial performance measures.

For example, an organisation established with the purpose of providing high-quality care and accommodation to older Australians cannot know whether it is achieving its purpose solely by looking at its profit for the year. It will be relevant to evaluate factors such as standards of clinical care and the health and wellbeing outcomes of clients. These are called non-financial performance measures.

There are several standard indicators that organisations can use to assess non-financial performance:

Figure 7: Examples of non-financial performance measures

Performance category	Possible indicators
Inputs	Number of staff or volunteer hours
	Number of staff or volunteers
	Number of donations of goods
Outputs	Number of sessions held (financial counselling service)
	Number of plays staged (community theatre)
	Increase in membership (community association)
Efficiency	Cost per bed (aged care facility)
	Cost of recruitment per member (professional association)
	Cost of class per student (school)
Effectiveness	Client satisfaction
	Brand recognition
	Quality of clinical care (hospital)

Efficiency measures demonstrate how well an organisation turns its inputs (e.g. financial resources) into outputs (e.g. meals). For example, a soup kitchen can determine the efficiency of its operations by calculating the number of meals it provides and the total cost of providing them to work out the cost of each meal.

Effectiveness measures demonstrate how well an organisation is achieving its objectives. These measures can be more difficult to determine because they are generally not as easy to quantify and may involve more subjective judgement. For example, a school might evaluate its effectiveness based on how well students perform against standardised tests. These measures are sometimes referred to as 'outcomes measures.'

In selecting non-financial performance measures, it is a good idea to consider a balance of efficiency and effectiveness measures to establish a more complete picture of performance.

> **!** *Some organisations may have legal or contractual obligations to report on certain measures as part of funding, contractual, regulatory or accreditation requirements.*

It is also important for organisations to assess how well they are performing against the expectations for their conduct (or behaviour) set by themselves and others such as government authorities, accreditation bodies and self-regulatory agencies. This is discussed in greater detail in *Principle 9: Conduct and compliance*.

Measuring impact

All NFPs exist for a purpose, but it can be challenging to evaluate precisely how well an NFP is working towards achieving its purpose. Some NFPs will have a purpose that is very difficult to evaluate such as eradicating poverty, or which may be ongoing such as cancer research.

Impact measurement refers to the process of evaluating how much change an organisation has achieved through its activities. For example, an organisation that provides employment services to deaf people might measure impact based on factors such as the workforce participation of their clients. To do this, an organisation might compare their clients against the broader workforce, against a control group of deaf people who are not their clients, or against the impact of their competitors.

Measuring impact is challenging and may require significant resources to do effectively. However, if possible, impact measurement is a valuable way to demonstrate an organisation's success in achieving their purpose, and can be useful in attracting donations and funding.

Reporting to the board

For the board to monitor the organisation's performance, and to make decisions that will help drive performance, they must have access to timely and relevant information. The main way this is achieved is through reporting to the board. Reports received by the board should be aligned to the strategy and include consideration of any defined performance measures.

The nature of this reporting will depend on the organisation's circumstances. The board should work with management to establish a reporting framework that provides access to the information they need, when they need it and in an appropriate format.

While it is important this information is provided to the board, directors should also actively seek more information if required as part of their duty of care and diligence. This is discussed in greater detail in *Principle 2: Roles and responsibilities*.

"Measuring impact is challenging and may require significant resources to do effectively. However, if possible, impact measurement is a valuable way to demonstrate an organisation's success in achieving their purpose and can be useful in attracting donations and funding."

QUESTIONS FOR DIRECTORS
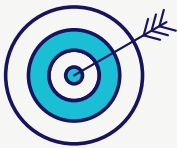
IS THE BOARD SATISFIED THAT THE ORGANISATION'S RESOURCES ARE PROTECTED FROM MISUSE?

IS THERE AN AGREED DEFINITION OF SUCCESS FOR THIS ORGANISATION?

HOW WELL IS FINANCIAL AND NON-FINANCIAL PERFORMANCE EVALUATED?

DO FINANCIAL PERFORMANCE TARGETS CONTRIBUTE TO LONG-TERM ORGANISATIONAL SUSTAINABILITY?

HOW DOES THE BOARD USE PERFORMANCE INFORMATION IN ITS DECISION-MAKING?

CASE STUDIES

HelpfulCare

HelpfulCare has established a resource management framework that sets out how the organisation's resources are to be used. As part of this they have developed specific policies around matters such as vehicle maintenance and acceptable use of technology.

The board undertakes an annual budgeting process which sets ambitious targets for profit and growth. HelpfulCare uses a zero-based budgeting model through which all expenses are justified for each new period and a revised budget is developed at the half-year mark in response to changes in the operational environment.

As part of their strategic plan, HelpfulCare have identified five key strategic goals which are supported by a series of measures. The board receives regular reports from management on the organisation's performance against these measures.

The board also receives regular financial reports which help them to monitor and reach an informed opinion on the organisation's financial health – including its solvency. Financial reports are prepared by management and reviewed by the board.

The board sets short, medium and long-term objectives for the CEO which are defined in an annual performance agreement. The CEO receives an annual appraisal as part of a process lead by the chair and reports at quarterly intervals to the board against defined criteria.

The Friendlies

The Friendlies maintain an annual budget which is developed by the board with the assistance of the coordinator. The budget remains substantively the same each year but is adjusted based on new membership figures or to accommodate specific projects.

Within the budget, only the coordinator is authorised to spend money on behalf of the Friendlies. For expenditure outside the approved budget or above a certain amount, the coordinator is required to seek the authority of the board.

The Friendlies have a five-year strategic plan which includes key targets towards which the organisation is working including growing their membership and saving money for community projects. Reports against these targets are provided by the coordinator at all board meetings. The board also reviews standard management accounts produced by the Friendlies' accounting software to consider how they are performing against their budget and to monitor solvency.

The coordinator's goals are the same as the organisation's strategic objectives. Every year the chair and two board members meet to review the coordinator's performance and to provide feedback.

PRINCIPLE 7

PRINCIPLE 7

Transparency and accountability

The board demonstrates accountability by providing information to stakeholders about the organisation and its performance

7.1 The organisation's governing documents and policies relevant to its governance are available to stakeholders

7.2 The board oversees appropriate reporting to stakeholders about the organisation's performance and financial position

7.3 Transactions between related parties, if any, are disclosed to stakeholders

7.4 Directors' remuneration and other benefits, if any, are disclosed to stakeholders

7.5 Members have the opportunity to ask questions about how the organisation is run and to hold the board to account for their decisions

The board has ultimate authority for the organisation and as such has ultimate accountability for its activities and performance. This means they must present a fair representation of the organisation's activity and take responsibility for the consequences of their actions and their and the organisation's performance.

What is accountability?

Accountability exists in a relationship between two parties where one has expectations of the other, and the other is obliged to provide information about how they have met these expectations or face the consequences of failing to do so.

There are two components of accountability:

- Answerability – which means providing information and justification for how one's actions align with expectations; and

- Enforcement – which means being subject to, and accepting the consequences of, failing to meet these expectations.

Because accountability in an organisation will involve multiple parties, it is important there is clarity about who is accountable to whom and how. The way this accountability is achieved will generally be set out in an organisation's governing documents, such as its constitution, and any laws that apply to it. For example, an NFP may be required to provide an annual financial report to its regulator and the penalty for failing to do this may be a fine.

It is important that the documents and policies that enable accountability are made available to relevant stakeholders. Subject to necessary confidentiality, usually this is done by providing such information on the organisation's website, but it should be available on request at a minimum.

For accountability to be achieved, there must be transparency.

What is transparency?

Organisations are transparent when they enable others to see and understand how they operate in an honest way. To achieve transparency, an organisation must provide information about its activities and governance to stakeholders that is accurate, complete and made available in a timely way.

Transparency enables accountability.

This does not mean all information should be made publicly available. There are certain types of information that may not be provided publicly such as private information (such as

client records) and 'commercial in confidence' material (such as tender submissions).

To whom are boards accountable?

The board is entrusted by its members to govern on their behalf. As a result, the primary accountability of boards is to their members.

There are several ways that boards can demonstrate accountability to their members. For example, by answering members' questions at general meetings and holding open and fair elections for board members. One of the ways boards are held accountable is through upholding their duties which are discussed in *Principle 2: Board roles and responsibilities*.

Boards may also be accountable to other sources including:

- Regulators, police and the courts;

- Government and non-government accreditation bodies;

- Clients and customers;

- Financial institutions such as banks;

- Funders and government departments through funding and service agreements; and

- Other individuals and organisations through contracts for service or employment.

It is important that boards understand to whom they are accountable and that they are satisfied they are meeting any obligations they have to them.

Annual reporting

One of the ways an organisation can demonstrate accountability to stakeholders is through publishing an annual report. An annual report is a document that includes governance and performance information about the organisation in a certain reporting period such as:

- Information about the organisation's purpose, vision, values and strategic goals;

- Statements from the organisation's leaders such as its CEO and chair;

- Profiles of directors and information about the organisational structure;

- Information about key organisational resources (such as staff and volunteers); and

- Information about the organisation's activities within the reporting period, including key statistics and performance data.

> !
>
> *An organisation's governing documents and any laws that apply to it may set out requirements in relation to publishing annual reports such as what it must include, to whom it must be provided and within what timeframe.*

Annual reports are also a valuable way for organisations to connect with their stakeholders. Many organisations use their annual reports as a way of demonstrating their achievements during the year to help stakeholders, particularly donors and volunteers, to understand how their contributions assisted in achieving the organisation's goals.

An annual report may contain the organisation's financial report or an extract.

Financial reporting

Many NFP organisations are required to produce a financial report and provide this to their members, funders or to lodge it on a public register.

> !
>
> *An organisation's governing documents and any laws that apply to it may set out requirements around the presentation of financial reports including what form they take and to whom they must be provided and within what timeframe.*

Many organisations are required to prepare their financial reports in accordance with Australian Accounting Standards. These standards are developed, issued and maintained by the Australian Accounting Standards Board (AASB) and set out the rules for the preparation and presentation financial statements.

To determine whether an organisation is required to apply with Australian Accounting Standards, directors will need to assess whether their organisation is a 'reporting entity'. The definition of a reporting entity is set out under Australian Accounting Standards.

> **STATEMENT OF ACCOUNTING CONCEPT 1: DEFINITION OF REPORTING ENTITY**
>
> Reporting entities are all entities (including economic entities) in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources.

Generally, if people use and rely on an organisation's financial statements to help them make decisions (for example, about how to spend money) and they can't command the organisation to provide this information, it will be considered a reporting entity.

Reporting entities must produce 'general purpose financial reports'. The definition of general purpose financial reports is set out under Australian Accounting Standards.

> **STATEMENT OF ACCOUNTING CONCEPT 1: DEFINITION OF REPORTING ENTITY**
>
> "General purpose financial report" is a financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs.

General purpose financial reports must comply with all Australian Accounting Standards.

Organisations that are not reporting entities may choose to produce 'special purpose financial reports'. These are a type of financial report that do not have to comply with all Australian Accounting Standards and which are prepared for the benefit of particular users. However, the users of these reports may require that they comply with certain Australian Accounting Standards. For example, organisations that are registered charities must comply with six minimum accounting standards.

It may be necessary for a financial report to be audited or reviewed depending on the requirements of regulators, funding providers or the organisation's governing documents and any laws that apply to it.

> **!** *An organisation's governing documents and any laws that apply to it may set out requirements around who must approve the organisation's financial reports. Often this will be the directors.*

General meetings

Many organisations hold an annual general meeting (AGM) which provides an opportunity for members and other stakeholders to gather, hear about the organisation's activities and finances for the previous year, and ask questions.

AGMs also provide an opportunity to undertake important governance activities that can only be done at general meetings of members such as electing board members and making changes to an organisation's governing documents. Generally, these activities will be undertaken through a vote of the members and it is important to make sure that any relevant procedures in relation to voting are followed.

> **!** *An organisation's governing documents and any laws that apply to it may set out requirements around holding AGMs such as regarding notice periods, the content of the notice, who has to be invited and any business that needs to be discussed.*

Sometimes it is necessary to gather members more often than once a year and so the board may call an additional meeting of members. These meetings are sometimes called special general meetings (SGM). An SGM might be called to deal with an item of business that cannot wait for an AGM such as authorising a merger or winding up the organisation. It is important to follow any procedures relevant to holding an SGM which will generally be set out in an organisation's governing documents and any laws that apply to it.

Disclosing related party transactions

It is not uncommon for NFP organisations, particularly smaller NFPs, to undertake transactions with people who are closely related to it. For example, a director might offer a discounted service to the organisation or their child might buy a used car from it. These transactions are called 'related party transactions'.

Because related party transactions occur between the organisation and someone closely associated with it, they must be carefully managed so that they meet any obligations under the law, including any requirements to disclose them.

> **!** *Organisations that are required to lodge general purpose financial statements must comply with the Australian Accounting Standard on related party transactions (AASB 124: Related Party Disclosures).*

Regardless of whether an organisation is required to lodge general purpose financial statements, it is a good idea to disclose related party transactions to promote transparency.

The definition of 'related parties' is set out in AASB 124 *Related Party Disclosures* and includes people such as the directors, the CEO, and other senior staff. It also includes the members of these peoples' close family that have control, joint control or significant influence over the organisation.

AASB 124 *Related Party Disclosures* also defines 'related party transactions':

> **RELATED PARTY TRANSACTIONS**
>
> A transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.

Related party transactions may include:

- Purchases or sales of goods or property;
- Donations made or received;
- Rendering or receiving of services; and
- Receiving or providing loans.

It is a good idea to develop a policy on related party transactions that sets out how they will be disclosed and managed. These policies also help promote transparency, and the proper and accountable use of resources.

Disclosing remuneration and other benefits

Most directors in the NFP sector are not paid (remunerated) for their work as a director. However, where directors do receive remuneration for their work, it is a good idea that this remuneration is disclosed to stakeholders.

Where remuneration is paid, there are several ways disclosure can be made, the most straightforward of which is to list directors by name and report their respective remuneration.

The example below demonstrates how this can be done for a fictional organisation:

Figure 8: Example director remuneration disclosure

	Remuneration	Superannuation	Total remuneration
Chairperson			
Giulia Bianchi	$6,000	$540	$6,540
Directors			
Fei Zhen	$4,500	$405	$4,905
Patricia Parsons	$4,500	$405	$4,905
Joko Prasetyo	$4,500	$405	$4,905
TOTALS	$19,500	$1,755	$21,255

This disclosure should include any other benefits that directors receive as payment for their work. For example, if directors are given cars as part of their payment, the cost of this benefit should be included in the disclosure.

An organisation's governing documents may also set out requirements around the payment of directors such as requiring the approval of members. It is a good idea to develop a policy on how remuneration is determined and approved.

NFPs that are required to comply with *AASB 124: Related Party Transactions* must disclose an aggregate figure for the remuneration of 'key management personnel' in their annual financial report.

The definition of key management personnel is set out under *AASB 124: Related Party Transactions:*

KEY MANAGEMENT PERSONNEL

Those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity

This definition includes directors and will also generally include the CEO and other senior staff such as the chief financial officer and the chief operating officer.

The example below demonstrates how this can be done for a fictional organisation:

Figure 9: Example key management personnel remuneration disclosure

	2018	2017
Compensation by category	*$'000*	*$'000*
Short-term employee benefits	493	422
Post-employment benefits	26	24
Other long-term employee benefits	55	49
Termination benefits	0	0
TOTALS	574	495

Organisations that are not required to produce general purpose financial reports may still choose to disclose the remuneration of their key management personnel on a voluntary basis.

QUESTIONS FOR DIRECTORS

TO WHOM IS THIS ORGANISATION ACCOUNTABLE?

WHAT INFORMATION DO STAKEHOLDERS/MEMBERS NEED TO HOLD THE BOARD TO ACCOUNT?

HOW IS REPORTING ALIGNED TO STAKEHOLDER/MEMBER NEEDS?

HOW CAN MEMBERS HOLD THE BOARD TO ACCOUNT FOR ITS DECISIONS?

WHAT ARE THE CONSEQUENCES FOR FAILING TO MEET MEMBER/STAKEHOLDER EXPECTATIONS?

CASE STUDIES

HelpfulCare

HelpfulCare provides an annual report to its members that sets out in detail how the organisation worked throughout the year and how it performed against its strategic objectives. The annual report includes an extract of their financial report and a full version of this is available on their website.

To keep their stakeholders informed about their activity, HelpfulCare uses a number of communications tools such as a magazine, email bulletins, a blog and social media.

Each year, HelpfulCare holds an AGM to which they invite their members and key stakeholders. At the AGM, directors and senior staff provide presentations on the key achievements for the year and invite questions from members.

The directors of HelpfulCare are each paid a small honorarium for their service and this is disclosed in their annual report. Directors receive $100 per meeting to cover the cost of their travel and expenses. The annual report also lists any related party transactions made during the year.

The Friendlies

Keeping their membership actively engaged is a key focus for the Friendlies. They do this through producing a monthly email newsletter where they focus on their recent activities and share stories about how their work has made a difference.

Members are also invited to attend quarterly 'town hall' meetings where they can hear verbal reports of the Friendlies' recent activities and ask any questions about their operations. Once a year, the town hall meeting includes an annual general meeting which includes the presentation of financial statements.

The Friendlies do not have a website and only use social media and email to engage with their membership. As a result, their governing documents are not available online, but they provide these documents to members on request and a copy is given to all new members.

The Friendlies do not pay their directors and this is widely known by stakeholders. They maintain a policy on related party transactions that requires directors to disclose any such transactions at one of their town hall meetings.

PRINCIPLE 8

PRINCIPLE 8

Stakeholder engagement

There is meaningful engagement of stakeholders and their interests are understood and considered by the board

8.1 The board understands who the organisation's stakeholders are, their needs and their expectations

8.2 The board oversees a framework for the meaningful engagement of stakeholders

8.3 Stakeholders are considered in relevant board decision-making

8.4 There is a process for gathering and responding to complaints and feedback from stakeholders

8.5 The board oversees a framework for how the organisation works with and protects vulnerable people

To govern effectively, boards must have an awareness of the stakeholder environment in which they operate and understand the needs and interests of these stakeholders. In certain circumstances, boards may also have obligations under the law about how they work with stakeholders. At the heart of stakeholder engagement is the acknowledgement that organisations are impacted by, and have an impact on those with whom they interact.

Identifying your stakeholders

All organisations have stakeholders, though who these are will vary based on factors such as the activities an organisation undertakes and its relationships. Boards should develop an understanding of who their stakeholders are, what their relationship to the organisation is, and what responsibilities the organisation has to them, if any. Often, the most important stakeholders for an organisation will be the people that the organisation exists to benefit (its beneficiaries).

Example of stakeholders include:

- Members;
- Suppliers;
- Clients and their families;
- Volunteers;
- Donors;
- Funders;
- Neighbours;
- Staff;
- Government;
- General public;
- Media;
- Carers.

In certain circumstances, directors may have legal obligations to their stakeholders either directly or through the organisation. For example, an organisation has a legal duty to take reasonable care to avoid exposing its workers, including any volunteers, to reasonably foreseeable risks of injury.

Do directors owe a duty to their stakeholders?

Directors' duties are generally owed to the organisation as a whole. That is, directors must act honestly, in good faith and to the best of their ability in the interests of the organisation. In practice, this means that a director owes their duties to the members of the organisation, and not to its other stakeholders.

However, an organisation may be subject to other statutory requirements (such as work health and safety legislation) that give rise to duties that directors owe to other stakeholders.

However, directors should consider the views and interests of stakeholders because they can lead to better and more balanced decisions in pursuing the organisation's purpose. Duties of directors are discussed in greater detail in *Principle 2: Roles and responsibilities*.

Engaging with stakeholders

Effective stakeholder engagement involves building relationships based on mutual trust, respect and understanding. Engagement is not an end in itself, but a means by which to build and develop relationships which help organisations to pursue their purpose.

Stakeholder engagement is beneficial both to organisations and to stakeholders. It provides valuable information to the organisation (such as about how it is perceived, its stakeholders' needs and its broader operational environment), builds goodwill and helps to identify potential issues for resolution.

Stakeholders benefit from these relationships too through helping organisations to better understand their needs and expectations. This engagement also helps stakeholders to develop a more informed understanding of the organisation and how to work with it, and to manage their expectations accordingly.

The board's role in stakeholder engagement

An organisation's relationships with its stakeholders can have a significant impact on its ability to achieve its goals. As such, boards should oversee the process of stakeholder engagement and be satisfied that its stakeholders are identified and understood. Stakeholder engagement is a critical component of good governance.

"Corporate Governance is concerned with holding the balance between economic and social goals and between individual and communal goals.

The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society."

Sir Adrian Cadbury

There are a several practical ways boards can do this. Boards should consider how stakeholders are impacted by relevant decisions, having regard to their needs and expectations, to maximise the chances that their decisions will lead to the desired outcome. Seen in this way, considering the influence of stakeholders is part of risk management which is discussed in greater detail in *Principle 5: Risk management*.

Some boards may authorise stakeholder engagement frameworks which help guide an organisation's work through identifying relevant stakeholders and setting the parameters for how to engage with them.

In some circumstances, directors themselves may become actively involved in managing relationships. For example, it is sometimes helpful for the chair or other directors to attend meetings with politicians in advocacy settings, or to meet with significant donors on behalf of the organisation. This can help to build personal relationships and to reflect the board's commitment to engaging with important stakeholders.

Responding to feedback

It is important that organisations have a safe and effective method for gathering feedback from stakeholders. This information can be used to inform the delivery of services, to develop an understanding of how the organisation is perceived and to identify and respond to potential concerns. Feedback should be viewed as a positive interaction between organisations and their stakeholders which provide an opportunity to learn and improve.

Feedback can be received in many ways; an individual might make a formal complaint about an organisation using an established complaint handling system or a comment may be made through an informal channel such as social media.

How an organisation gathers and responds to this feedback can have a significant impact on its performance, reputation and culture. For example, if an organisation does not act on feedback or is dismissive of people who raise concerns, this may impact how it is perceived by stakeholders and create a culture in which stakeholders are not valued.

In some circumstances, complaints (especially those which are repeated or serious) may be an indicator of poor performance, misconduct or may in some instances be a breach of the law.

It is a good idea to set out a policy for how the organisation will respond to complaints and other feedback. This policy should apply to all paid and volunteer staff and should include to whom a complaint can be made, how it will be handled, expected timeframes and a process for communicating any resolutions.

Boards should aim to develop a culture of disclosure which recognises that feedback from stakeholders, even complaints or allegations of wrongdoing, is an important source of insight that can help an organisation achieve its mission and avoid misconduct.

Protecting vulnerable people

Many NFPs, because of the nature of their work, will regularly interact with vulnerable people. However, all organisations that operate in the community may interact with vulnerable people and, where they do, it is important that there are systems and processes in place to protect them from harm.

The term 'vulnerable people' refers to people who are susceptible to harm or exploitation by reason of age, illness, trauma, disability or for any other reason.

> **!** *Many organisations will be subject to additional legal requirements and obligations in relation to the care of vulnerable people.*

Boards play an important role in protecting vulnerable people such as through overseeing risk management, compliance with relevant laws and a policy framework that protects vulnerable people. Perhaps most importantly, the board must seek to develop and maintain a culture which prioritises the safety of vulnerable people.

QUESTIONS FOR DIRECTORS

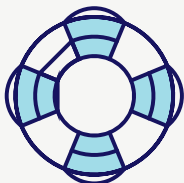**WHO ARE THE STAKEHOLDERS OF THIS ORGANISATION?**

HOW ARE THE NEEDS OF STAKEHOLDERS CONSIDERED BY THE ORGANISATION?

HOW DO STAKEHOLDERS PERCEIVE THE ORGANISATION AND WHAT IS THE IMPACT OF THIS?

HOW DOES THE BOARD ACCESS AND RESPOND TO FEEDBACK FROM STAKEHOLDERS?

HOW ARE VULNERABLE PEOPLE PROTECTED BY THIS ORGANISATION?

CASE STUDIES

HelpfulCare

HelpfulCare has developed a comprehensive stakeholder engagement framework that identifies who their stakeholders are, as well as how the organisation understands their needs and expectations. The framework sets out a principles-based approach to stakeholder engagement grounded in respect, participation and transparency.

As part of their formal decision-making process, the board considers how their decisions will impact and may be impacted by stakeholders. To maintain an ongoing connection with stakeholders, board meetings begin with a 'client story' which helps directors to focus their minds on how their work impacts stakeholders. Directors also regularly engage with stakeholders through site visits and by participating in consultative forums.

HelpfulCare actively seeks opportunities to gather feedback from stakeholders and uses mechanisms such as client surveys and market research to develop a more fulsome picture of performance. They have also established policies for responding to compliments and complaints so that feedback is appropriately acted on.

Many of HelpfulCare's clients are considered to be vulnerable people and they have established robust systems and processes which aim to keep their clients safe. Among these are compliance with relevant clinical care standards and the adoption of the 'National principles for child safe organisations.'

The Friendlies

The Friendlies are a democratic, community-controlled organisation and stakeholder engagement is central to what they do. Their regular 'town hall' style meetings provide an opportunity for stakeholders to gather and to develop a shared vision for how the Friendlies should work.

Stakeholders are also regularly surveyed about their priorities and there are regular votes for members to choose between multiple project opportunities. The board use this information to guide their decision-making and are regularly encouraged by the chair to consider what stakeholders would want.

Complaints to the Friendlies are handled in accordance with their complaints management policy which requires that any formal complaint is reviewed by the board.

The Friendlies have a policy on working with vulnerable people. One part of the policy includes a requirement that all of their volunteers maintain a working with children check and undergo an annual police records check. They also make sure all volunteers are trained in the policy, and that is reviewed annually.

PRINCIPLE 9

PRINCIPLE 9

Conduct and compliance

The expectations of behaviour for the people involved in the organisation are clear and understood

9.1 The board articulates its expectations of conduct, and the consequences for misconduct, for the people involved with the organisation

9.2 The board oversees compliance with relevant laws, regulations and internal policies

9.3 Conflicts of interest are identified, disclosed and managed

9.4 There is a process for investigating misconduct and relevant instances are brought to the attention of the board

For an organisation to work effectively, there must be clear expectations about how the people involved with it are expected to behave. Boards play an important role in defining acceptable behaviours and in establishing frameworks that enable action when unacceptable behaviours occur.

Although much can be done through policies and practices to shape behaviour, one of the most powerful influences on the behaviour of people involved with an organisation is culture. For this reason, Principle 9: Conduct and Compliance is closely linked with *Principle 10: Culture*.

Codes of conduct

Codes of conduct are policy documents that describe the behaviours (conduct) expected of the people involved in an organisation. The board will generally approve the code of conduct and it will apply to all people involved in the organisation such as staff, volunteers, members and directors.

These codes will generally include:

Standards of governance

For example, privacy, disclosure of conflicts of interest, and compliance with internal policies

Standards of behaviour

For example, respect for diversity, use of organisational resources and professional communication

Unacceptable behaviours

For example, prohibiting use of illicit substances, sexual harassment, and bullying

Codes of conduct take many forms; some are highly prescriptive, prohibiting certain actions or behaviours, while others are more principles-based. The common goal of codes of conduct is to provide guidance to the people involved with an organisation about how they are expected to behave. For this reason, it is common for codes of conduct to include a discussion of these expectations, relevant examples and links to relevant internal policies.

It is important that a code of conduct is enforced. The consequences for failing to comply with the code of conduct should be clearly set out, as well as the mechanisms for how this will be determined and enforced. Boards should be prepared to make difficult decisions to enforce the code of conduct and to empower management to do the same.

Complying with the law

All organisations must comply with the law. It is important that boards understand the legal framework that applies to their organisation and that they are satisfied with the steps taken to comply.

The laws that apply to an NFP will depend on the nature of the organisation. Some laws, such as taxation laws and the criminal code, apply to all organisations. Other laws may only apply based on the type of activity the organisation is undertaking such as the laws around preparing and storing food or fundraising.

It is generally not possible for a board to know every law that applies to their organisation in detail or to evaluate for themselves whether the organisation is complying with every relevant law. However, there are ways that a board can oversee compliance with the law, for example, by:

· Seeking independent review of proposed decisions;

· Establishing a policy framework that requires staff to follow relevant laws;

· Maintaining integrity of internal and external audit processes;

· Promoting a culture of compliance;

· Seeking independent legal advice where necessary; and

· Establishing robust systems for reporting and investigating misconduct.

Boards can and should apply a similar approach to requiring compliance with their governing documents and internal policies. Boards may be interested to inquire into how management maintains compliance with policies such as through providing regular training, internal communications or through requiring compliance through employment contracts.

Conflicts of interest

Directors have a duty to act in the best interest of their organisation. At times, a director's personal interests (such as their investment interests) or their other duties (such as to another organisation of which they are a director) may conflict with this duty. This is called a conflict of interest.

Conflicts of interest can also affect other people involved with the organisation, such as management and staff, and it is important that these conflicts are also identified and managed.

There are three types of conflicts of interest:

Figure 10: Types of conflict of interest

Actual	Potential	Perceived
There is a direct conflict of interest. For example, you are in a close personal relationship with an employee of the organisation you are a director of.	**There could be a conflict of interest.** For example, you are a director of two charities that may both compete for the same grant in the future.	**There may appear to be a conflict of interest.** For example, you are an investor in a company that your board may be perceived to be able to influence.

Conflicts of interest can't always be avoided and do not necessarily represent a problem. However, it is important that they are managed properly so that directors are acting in the best interest of the organisation and to protect the organisation's reputation.

The first step to managing conflicts of interest is identification. Conflicts of interest should be recorded so that there is transparency about what directors' interests are. Many organisations maintain a register of directors' interests, which records any relevant interests that may give rise to a conflict now or in the future. This also assists with appropriate oversight and transparency of these interests. It is good practice for the chair to invite directors to declare any conflicts of interest at the beginning of a meeting.

> **!** *An organisation's governing documents and any laws that apply to it may set out requirements about the management and disclosure of conflicts of interest.*

Once a conflict has been identified, the board must decide how it will be managed. For example, it may be required that the conflicted director:

- Refrain from participating in any discussion about related matters;

- Remove themselves from the room; or

- Abstain from voting on any matter related to the conflict.

This is called taking remedial action. The appropriate remedial action will depend on the nature of the conflict and boards will need to determine how best to manage a conflict based on the circumstances of the situation.

If a remedial action is taken to manage a conflict of interest, it should be recorded in the minutes. In certain circumstances, a directors' interests may be conflicted so regularly or to such an extent that it is not practical for them to continue in their role and it will be in the best interests of the organisation that they resign.

It is a good idea to set out in a policy how conflicts of interest will be managed. This policy should provide guidance on when disclosures are expected, how they are to be made and how failures to identify conflicts will be responded to. It should also reflect any relevant requirements in the organisation's governing documents and any laws that apply to it.

Importantly, a conflicts of interest policy should emphasise the importance of creating a culture of disclosure. If in doubt about whether something could be a conflict of interest, it is always best to err on the side of caution and to disclose it. This can also assist in promoting accountability, especially if there is visibility of the disclosure by an organisation's stakeholders.

Reporting and responding to misconduct

Even the best policies and procedures will not always prevent wrongdoing within organisations. Where this occurs, it is important that there are systems in place to investigate reports of wrongdoing and to take action to address any misconduct.

The board plays an important role in this, particularly in driving a culture of reporting and not turning a 'blind eye.' Bad news should travel quickly and easily through the appropriate parts of organisation so that it can be responded to at the earliest opportunity. Boards should encourage reporting of wrongdoing and satisfy themselves that the organisation has appropriate processes in place to detect and address it. It may be appropriate for certain types of information about wrongdoing to be brought to the attention of the board so that they can provide appropriate oversight of the organisation's investigation and response.

One way boards can approach this issue is through regularly reviewing information about the organisation's performance against the standards of behaviour it seeks to meet, whether those standards are set by the organisation (such as through its code of conduct) or by the law (such as through regulation) or another source (such as accreditation standards).

There are several standard indicators that organisations can use to assess their conduct performance:

Figure 11: Examples of conduct performance measures

Performance category	Possible indicators
Conduct	Instances of misconduct
	Legal and regulatory breaches and outcomes
	Complaints from stakeholders
	Outcomes of stakeholder complaints
	Breaches of policy or service standards

Other aspects of performance measurement are discussed in greater detail in *Principle 6: Performance*.

Protecting whistleblowers

Boards should also be satisfied that the people who report wrongdoing are protected from any retribution. These people are often referred to as 'whistleblowers'. Reports of wrongdoing may come from a range of sources including current and former staff, contractors, volunteers, clients and suppliers. These people are an important line of defence against wrongdoing and providing them with adequate protection against retribution can encourage them to come forward with valuable information.

> **!** *There are laws that provide protection to whistleblowers where they raise issues of wrongdoing in certain circumstances. It is important to know and understand how these laws apply and to comply with them.*

It is a good idea to establish a whistleblower policy that sets out:

· Who can make a disclosure (which should ideally include as broad a range of people as reasonably practical);

· How they can make a disclosure (including to whom, by what method and whether they can do so anonymously);

· The matters about which they can make a disclosure;

· The protections they will receive (including any protections under the law);

· How their disclosure will be investigated;

· How the organisation will communicate with them about the investigation; and

· The consequences for people who take retribution against whistleblowers.

"Whistleblowers are an important line of defence against wrongdoing and providing them with adequate protection against retribution can encourage them to come forward with valuable information."

QUESTIONS FOR DIRECTORS
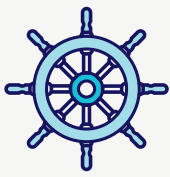
ARE THE BEHAVIOURAL EXPECTATIONS OF THE BOARD CLEARLY ARTICULATED?

WHAT ARE THE CONSEQUENCES FOR FAILING TO MEET BEHAVIOURAL EXPECTATIONS?

HOW EFFECTIVELY ARE CONFLICTS OF INTEREST MANAGED BY THE BOARD?

HOW DOES THE BOARD RESPOND TO BAD NEWS?

WHAT PROCESSES ARE IN PLACE TO PROTECT WHISTLEBLOWERS?

CASE STUDIES

HelpfulCare

The board of HelpfulCare have authorised a code of conduct which applies to all staff, volunteers and directors involved with the organisation. The code sets out clear expectations of behaviour for these people and includes detail on how the organisation will respond to instances of misconduct.

All staff and volunteers at HelpfulCare are taken through relevant policies, including the code of conduct, as part of their induction. The board has also set a goal for management to deliver ongoing and regular training to staff and volunteers on key policies.

The board has a detailed policy on the management of conflicts of interest. All directors are required to record relevant interests in a register as soon as they become aware of the conflict. The minutes always record any interests relevant to decision-making and the remedial action taken to address them.

HelpfulCare employ an independent third party to provide a confidential service through which staff and volunteers can report misconduct. Aggregate information about reports is provided to the board and any report concerning serious misconduct is provided to the board in full. The board has also established a whistleblower protection framework to protect the people who report wrongdoing.

The Friendlies

The Friendlies' have a behavioural code called 'The Friendly Way' which sets out the minimum behavioural expectations for members including positive behaviours. The code also requires that members comply with other organisational policies.

All members of the Friendlies are required to follow the code. The governing documents of the Friendlies set out a process that can be used in instances of misconduct (not complying with the code is a form of misconduct).

At the beginning of board meetings, the chair invites members to disclose any conflicts of interest relevant to items on the agenda. The chair reminds directors that it is a legal requirement to declare any personal interest. The board requires directors leave the room for any issue in which they have a conflict and that is noted in the minutes. They choose to be 'better safe than sorry.'

The board has established a complaints policy which includes a procedure for responding to instances of misconduct. It makes sure all new members get a copy of the policy (and 'The Friendly Way') when they first become members, or when changes are made.

PRINCIPLE 10

PRINCIPLE 10

Culture

The board models and works to instil a culture that supports the organisation's purpose and strategy

10.1 The board defines and models a desired culture that aligns to the purpose and strategy

10.2 The board oversees a strategy to develop and maintain the desired culture

10.3 The board oversees mechanisms to monitor and evaluate organisational culture

10.4 The organisation's values are clear, periodically reviewed and communicated to stakeholders

10.5 The board oversees a framework for the reward and recognition of workers

A strong culture is an invaluable asset to an organisation and can contribute significantly to an organisation's ability to achieve its purpose. However, a poor culture can undermine an organisation's performance. The board plays an important role in shaping an organisation's culture, including through leading by example.

What is culture

Culture represents the shared values, assumptions and beliefs that shape the behaviour of the people involved in an organisation. It is often described as the way people act when nobody is looking. Culture can seem like a nebulous concept, but while it may be difficult to measure or define, it is a powerful influence on the people involved in an organisation and their actions.

Good cultures are aligned to an organisation's purpose and support the achievement of its goals. For example, if your purpose is to educate primary school children, the ability to do this will be enhanced by a culture that prioritises the best interests of the child and places emphasis on high standards in teaching and child welfare.

Conversely, poor cultures can adversely impact an organisation such as through its impact on staff morale, absenteeism and the organisation's ability to attract and retain volunteers. Culture is also a significant factor in the perception of an organisation by its funders, donors and the community. In some circumstances, poor culture can even result in misconduct.

It is also important to recognise that there may be multiple cultures within an organisation. Different attitudes and practices may emerge, and be actively cultivated within particular teams, for example.

Monitoring culture

There is no single metric that can be used to evaluate the culture of an organisation. Instead, boards must consider a range of data sources to build a picture of culture through combining both quantitative and qualitative information.
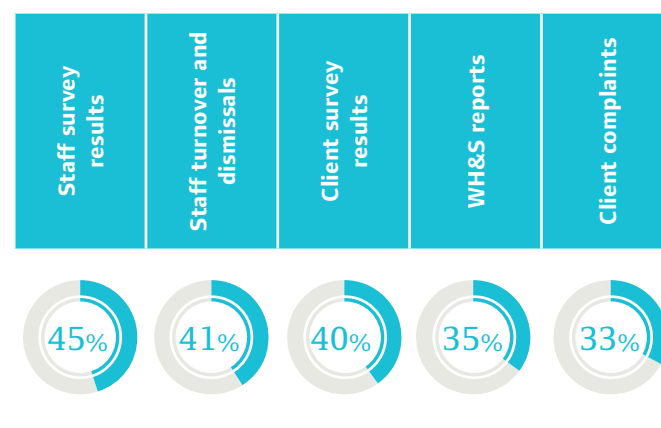
Measuring culture does not necessarily have to involve the development and measurement of new performance indicators specific to culture. Most organisations already have access to a range of data that can be used to build a picture of their culture.

"And now here is my secret, a very simple secret: it is only with the heart that one can see rightly; what is essential is invisible to the eye."

Antoine de Saint-Exupéry, *The Little Prince*

According to the AICD's 2018 NFP Governance Study the top five ways that NFPs measure culture are*:*

Figure 12: Top five ways of measuring culture

Staff survey results	Staff turnover and dismissals	Client survey results	WH&S reports	Client complaints
45%	41%	40%	35%	33%

(Source: AICD *2018 NFP Governance and Performance Study*)

There are also other ways through which the board can develop a sense of what the organisation's culture is. For example, the board might review the decisions and actions of management to determine whether they are consistent with the organisation's desired culture. Many boards also engage directly with clients, staff and volunteers to build a picture of culture based on personal interactions. However, care should be taken to keep the CEO informed about any such activities.

The board's role in culture

The board and its directors play a critical role in shaping an organisation's culture. Because culture can significantly influence an organisation's ability to achieve its purpose, it is important that boards form a view on what kind of culture will best support the achievement of their purpose and take steps to develop or maintain it.

"The fish rots from the head."

Ancient Chinese proverb

There are several different ways that boards can engage with and practically influence an organisation's culture. For example, the selection of a CEO can have an enormous impact on culture. Setting out a code of conduct for an organisation can also influence the organisation's culture, as can establishing remuneration structures that incentivise desired behaviours.

Every action of the board has potential to influence the organisation's culture in some way. For example, if a board approves a budget which makes generous provision for learning and development and requires reporting on how much time staff spend undertaking training, over time this is likely to contribute to creating a culture that values ongoing education. Although such decisions might not be considered through a cultural lens, they have the potential to influence an organisation's culture in small but powerful ways.

It is not only the board's decisions that have the potential to influence culture, but also its behaviours and attitudes. How board members interact with one another, the questions that they ask of management and the way they conduct their meetings can all influence culture. In this way, the culture of the board itself ripples through the organisation. This is called setting the 'tone from the top'.

Managing culture should therefore involve ongoing reflection by directors about how their decisions and behaviour shape their organisation's culture. The cultural impact of board decision-making should be a consideration in decision-making. Boards should also consider how their organisation's culture might impact the certainty with which the intended outcomes of their decisions will be achieved – considering culture from a risk management perspective.

A simple way to keep this fresh in the minds of directors is to make sure that culture is a regular agenda item for board meetings.

Organisational values

One of the practical ways that a board can influence culture is through defining organisational values. Values are an expression of the organisation's identity and are intended to guide the behaviours and decisions of the people involved with the organisation.

For example, if an organisation has the value of 'excellence in client service', that may mean that they do not provide services unless they are confident they meet a certain standard, or that they prioritise rectifying service issues when they occur over other issues.

For values to be effective they need to provide clear guidance about what an organisation considers to be good. At times, holding true to an organisation's values can be challenging, however, it is important that boards are prepared to make difficult decisions to stay true to their values.

Boards must approve the organisation's values and also work within them. They should be guided by the organisation's values in their own decision-making and should also challenge decisions of management when they are not in line with the organisation's values. Values are not meaningful unless they are observed and there are consequences for failing to observe them.

Culture and incentives

An important influence on an organisation's culture is the way staff and volunteers are incentivised to behave. These incentives may be material (such as through pay rises, bonuses or gifts) or non-material (such as increased seniority, certificates of appreciation or public recognition).

The board should oversee a reward and recognition framework that aligns incentives to the organisation's purpose. It is important that incentives are aligned to the organisation's purpose so that the people involved in the organisation are working towards the same goals.

The way behaviours are incentivised or discouraged sends an important message about what the organisation values are and what it is trying to achieve. It is also important that these incentives are realistic and achievable. For example, if an employee is incentivised to do their job too quickly, this may encourage them to rush or cut corners, and may adversely impact the organisation's purpose or even result in misconduct.

Not all incentives are rewards. Some incentives are negative, such as the possibility of a penalty for failing to meet defined expectations. It is important that there are negative incentives to discourage behaviours that are inconsistent with a desired culture or stated expectations of conduct.

Boards should be prepared to make difficult decisions to enforce culturally appropriate behaviours and empower management to do the same. In certain circumstances, such as where the behaviours are extreme or repeated, it may be necessary to terminate a person's connection with the organisation to protect the culture.

QUESTIONS FOR DIRECTORS

WHAT SORT OF CULTURE WILL BEST SUPPORT THE ORGANISATION TO ACHIEVE ITS OBJECTIVES?

WHAT IS THE CULTURE OF THE ORGANISATION AND HOW IS THIS DISCERNED?

HOW OFTEN DOES THE BOARD DISCUSS CULTURE?

DO THE BEHAVIOUR OF STAFF AND VOLUNTEERS ALIGN TO THE ORGANISATION'S VALUES?

HOW DOES THE BOARD ALIGN ITS DECISION-MAKING TO ITS VALUES?

CASE STUDIES

HelpfulCare

HelpfulCare has established a policy document titled 'Being HelpfulCare' that articulates their desired culture alongside their strtegic statements.

The 'Being HelpfulCare' policy sets out the organisation's values and the cultural behaviours that staff are expected to exhibit. Anyone can access the policy on HelpfulCare's website.

The board has directed management to act within the limits of this policy and to find ways to bring the policy to life. As a result, cultural fit is assessed in the recruitment process and positive examples are celebrated through internal communications. The board set the principles and practices for reward and recognition of employees to promote alignment with culture.

The board regularly considers culture as part of their formal decision-making process. The board also requires that culture be considered in the context of recruitment and the executive have authority to manage staff who exhibit behaviours that are inconsistent with the cultural norms.

Measuring culture is a critical focus for HelpfulCare. The board has instructed management to undertake annual staff engagement and client perception surveys. The board also reviews performance measures such as staff turnover and work health & safety reports, and a selection of client feedback is presented for board review at each meeting.

The Friendlies

The Friendlies' behavioural code called 'The Friendly Way' also sets out what their culture should be. The governing documents require the board to behave in a way that is consistent with the code and to promote it to members.

To assess how well the organisation is meeting its cultural goals, the board conducts a survey of members every two years. In the survey they ask how well the organisation is living up to 'The Friendly Way' and what steps the organisation could take to continue to improve.

'The Friendly Way' also sets out the organisation's core values. In assessing new projects, the board is required to evaluate their alignment to the organisation's values.

The board has required that demonstrating the organisation's values and adhering to 'The Friendly Way' are part of the employment contract of the coordinator. The board also work to identify members who have been exemplars of the values and reward them through public recognition involving either commemorative awards or letters of appreciation from the president.

Glossary

Agenda	A document that sets out what business will be considered a meeting
Australian Charities and Not-for-profits Commission (ACNC)	The national independent regulator of charities
ACNC Governance Standards	Five standards of governance that apply to registered charities
Annual report	A report about an organisation's activities, governance and performance
Annual general meeting (AGM)	An annual meeting of an organisation's members
Board	The people responsible for governing and controlling an organisation
Board committee	A group of people authorised by the board to assist with its work
Chair	A person appointed to manage the business of the board
Charities Act 2013	The law that sets out the definition of 'charitable purpose'
Charity	An NFP that meets the legal definition of charity
Chief executive officer (CEO)	The most senior member of an organisation's staff
Committee members	People appointed to a committee of the board
Company Limited by Guarantee	A type of entity incorporated under the Corporations Act
Company secretary	A person appointed to facilitate corporate governance processes
Conflict of interest	When a person's personal interests conflict with their duties
Corporations Act 2001	The law relating to corporations
Culture	Shared values, assumptions and beliefs that shape the behaviour of the people involved in an organiastion
Director	The members of an organisation's board
Directors' duties	The legal duties of directors to their organisation
Financial statements	Financial reports prepared for external audiences
Incorporated Association	A type of entity incorporated under state or territory legislation
Indigenous Corporation	A type of entity incorporated under the *Corporations (Aboriginal and Torres Strait Islander) Act 2006*
Governance	The systems and process that direct and control an organisation
Governing documents	The documents that set out how an organisation is to be run such as its constitution

Key performance indicator (KPI)	The measures that an organisation uses to evaluate its success
Management	An organisation's staff, particularly its senior staff
Management accounts	Financial reports prepared for internal audiences
Misconduct	Behaviours that violate policies or law
Minutes	Documents that record the activties and decisions of a meeting
Mission	Statements that express what an organisation does to achieve its purpose
Non-executive director	A director who is not a member of management
Not-for-profit (NFP)	An organisation that does not operate for private benefit
Principles	Statements that express what an organisation does to achieve this purpose
Purpose	The reason an organisation exists
Registered charity	A charity registered with the ACNC
Reserves	Unrestricted funds available to spend at the organisations discretion
Risk	The effect of uncertainty on objectives
Solvency	An organisation's ability to pay its debts as and when they are due
Special general meeting (SGM)	An ad hoc meeting of an organisation's members
Stakeholders	People involved with the organisation (such as clients and staff)
Strategy	The way an organisation defines its goals and aligns its activities and resources with them
Tenure	The period of time that a director is appointed for
Terms of reference	A document that governs the operation of a committee
Quorum	The number of directors that must be present for a meeting to be valid
Values	Statements that express what an organisation considers to be good
Vision	Statements that express what an organisation aims to achieve

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About the author

Lucas Ryan GAICD was a Senior Policy Adviser at the Australian Institute of Company Directors. He drove the AICD's advocacy agenda in the not-for-profit sector, as well as on innovation and technology. Between 2015 and 2017 he delivered the not-for-profit component of the AICD's 'Essential Director Update' and has been a contributing author to the annual *Not-for-profit Governance and Performance Study*.

Prior to working at the AICD, he was a foundation staff member of the Australian Charities and Not-for-profits Commission, establishing the governance education and stakeholder engagement programs for the newly-formed regulator. He is a graduate of the *Company Directors Course* and has had experience on not-for-profit and government boards.

About the external reviewers

Sue Woodward is the Head of Not-for-profit Law, a program of JusticeConnect. Before that, she worked as a corporate lawyer and academic at the University of Melbourne. Her extensive experience in the not-for-profit sector includes several years as a member of the senior leadership team at the Australian Charities and Not-for-profits Commission with responsibility for policy, education and red tape reduction. She holds a number of non-executive director positions on not-for-profit boards.

Nadine Clode is a Manager at Not-for-profit Law and has had broad experience as a senior official in both state and federal governments. She is a lawyer and educator with experience working with not-for-profits over a number of years, and has previously lectured in law at Federation University Australia. Nadine was also a member of the steering committee for the review of the *NFP Governance Principles*.

ADDITIONAL RESOURCES

· Online versions of the Principles are available at **companydirectors.com.au/nfpprinciples**
   along with a suite of relevant tools and content to assist users

· Further NFP resources including director tools are available here:
   companydirectors.com.au/resources/not-for-profit-resources