GOOD GOVERNANCE PRINCIPLES AND GUIDANCE
for Not-for-Profit Organisations

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PREAMBLE –
SETTING THE SCENE

The Good Governance Principles and Guidance for Not-for-Profit Organisations (Principles and Guidance) have been created by the Australian Institute of Company Directors as part of our commitment to the not-for-profit (NFP) sector and its directors.

We are committed to promoting world-leading performance of Australian boards and directors. The objective is to share with the NFP community some key principles that we believe are a useful starting point for NFP boards when considering what constitutes good governance practice (with regard to their particular circumstances).

The Principles and Guidance are an extension of our commitment to the NFP sector and demonstrate how we seek to support organisations and their directors to achieve better outcomes through good governance.

The Principles and Guidance:

• Are designed to promote and facilitate the crucial conversations and associated activities NFP organisations undertake regularly to achieve good governance.

• Are not an attempt to formulate rules on what might constitute good governance practice for NFP organisations, or prescribe related behaviours and specific actions.

Consultation on the draft Principles and Guidance

We undertook a public consultation process with NFP leaders and directors during February/March 2013 on a draft of the Principles and Guidance. To develop and gain industry support, we invited interested stakeholders to provide feedback on the draft Principles.

The consultation was conducted in three stages:

1. Feedback sought from our committees and division councils.

2. Roundtables with NFP directors and representatives across metropolitan and regional Australia.

3. Online public consultation for all interested stakeholders.

During the consultation, many contributors commented on the diversity of the NFP sector. NFPs range from large national organisations with experienced boards, professional management and fundraising, paid staff and prominent brands through to small, sometimes remote, community groups reliant upon passionate leaders, committed volunteers and limited resources. The larger and more mature an organisation is, the more likely it will already have adopted comprehensive governance practices and procedures similar to those used by companies listed on the Australian Securities Exchange (ASX).[1]

Smaller community organisations with dedicated directors still may not have anyone on the board with corporate experience or exposure to sophisticated governance practices.

A large majority of those consulted believed:

· These Principles are relevant and sound.

· The accompanying commentary (Guidance) is helpful.

· The "questions for consideration" are a valuable and practical resource for NFP boards.

At almost every session, participants noted smaller organisations would consider issues as required and had different governance needs and expectations. As NFPs grow and/or mature, their approach to governance is likely to become more involved and detailed to meet the applicable standards relevant to them.

The laws, regulations and standards which organisations must comply with differ slightly based upon the organisation's structure and relevant legislative jurisdiction.

Also, during the consultation a number of people observed the differences between NFP organisations, including:

· Size and maturity may differ.

· Their reliance upon volunteers or paid staff may vary.

· Their money might come from different sources (e.g. donations, bequests, product/ merchandise sales, government grants).

However, it is important to note that directors of those organisations still had the same or very similar legal duties and obligations.

Directors' duties and responsibilities

The legal duties of an NFP director depend – in part – on the legal form of the organisation they help govern.

These legal forms include (but are not limited to) companies limited by guarantee, incorporated associations and charities registered with the ACNC. Directors are best advised to refer to the directors' duties and responsibilities covered under the relevant Act(s) for their organisation.

In addition to these principal Act(s), there are potentially hundreds of other Commonwealth, state and territory statutes that could impose liabilities on directors of NFPs, depending on the activities of the NFP. For example, competition law, workplace health and safety, privacy legislation and taxation.

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[1] Including applying many of the ASX Corporate Governance Council's Principles and Recommendations and possibly reporting to interested parties how their approach to governance lines up against those ASX Principles.

NFP
REFORM PROCESS

The Principles and Guidance are being released at a time of significant reform for the NFP sector. We strongly believe – given the level of attention being placed on the governance of NFP organisations – an industry-driven, practical and useful framework for good governance is vital.

Recent reform in the NFP space has included a revised Associations Act in Victoria and the introduction of the Australian Charities and Not-for-profits Commission (ACNC) at a national level, which will initially impact only on charities.

This unprecedented level of reform has the potential to cause confusion among the NFP governance community, in particular how the Governance and Reporting Standards under the ACNC legislation interact with our Principles and Guidance.

The short summary below will help compare and contrast the two.

Governance Standards vs. Principles and Guidance

The Australian Charities and Not-for-profits Commission (ACNC)[2] was established in December 2012. The background[3] section of the ACNC Act comments on the regulatory framework and its commencement on 1 July 2013. It notes that:

"…establishes a framework for a set of minimum governance standards to apply to registered charities … Charities will need to comply with these standards to be, and remain, registered with the ACNC.

The governance standards are intended to reflect a minimum set of outcomes for registered charities, rather than mandate 'best practice governance' or detailed procedures and requirements necessary for effective not-for-profit (NFP) governance."

Our Principles and Guidance offer a practical, sector driven, non-prescriptive framework that can assist NFP organisations (including, but not limited to, charities) to understand what constitutes good governance practice to adapt as appropriate and apply having regard to their particular circumstances – purpose, structure, size and available resources.

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[2] The ACNC began operations on 3 December 2012 following Royal Assent of the ACNC Acts.

[3] Development of Governance Standards – Consultation Paper 2012
(http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2012/Governance-Standards-for-the-Not-for-profit-Sector)
Section 2 of the Consultation Paper, Page 5 and following.

INTRODUCTION

Not-for-profit organisations (NFPs) play a vital role in society, in many cases directly impacting on the quality of people's lives.

As discussed, NFPs exist in many different forms and sizes and operate for many different purposes or to achieve various objectives. They deliver vital services and support across many facets of community life, including:

- Health

- Aged care

- Social services

- Education and research

- The environment

- Community support and leadership

- Religion

- Culture, recreation and sports

NFP organisations come in various legal forms, including:

- Public companies limited by guarantee

- Unincorporated associations

- Incorporated associations under state or territory law

- Co-operatives

- Organisations established by special Acts of Parliament

Some may operate as charities, some may require volunteers in their operations, some may be well resourced and some may be clubs and societies operating at a local or national level.

NFP directors play a critical part in NFPs achieving their outcomes, giving up their time, most often voluntarily, to bring a wide range of skills to the oversight, management, fundraising and day-to-day operations of the NFPs they govern.

Corporate governance refers to the systems and processes put in place to control and monitor – or 'govern' – an organisation. Good governance is embedded in the good behaviour and the good judgement of those who are charged with running an organisation.

Good governance can offer a number of important benefits to charitable and/or NFPs, including:

- Better organisational strategies and plans.

- Improved operational effectiveness.

- More prudent regulatory compliance, financial and risk management.

- Improved member and stakeholder engagement and communication flow.

- Increased likelihood and degree to which an organisation actually delivers on its purpose.

Effective governance structures allow organisations to create value, through innovation, development and exploration, and provide accountability and control systems commensurate with the risks involved.

No matter the size, purpose and maturity of the NFP, directors need to consider various issues including whether they have the right structures and current constitutions in place to:

- Exercise their authority appropriately.

- Ensure controls and the right depth of financial knowledge is being applied for the good of the NFP and their own individual protection. For example, how the organisation is funded is important because directors may be required to be active fundraisers and/or closely monitor the allocation of money from government grants.

As the pre-eminent NFP governance organisation in Australia, the Australian Institute of Company Directors plays an important role in assisting individual directors and boards to govern effectively.

One of our goals is to provide leadership on director and governance issues in the NFP sector to achieve a positive impact for the sector, economy and society. These Principles and Guidance are part of our commitment to achieving this goal.

We have a range of services and education programs designed specifically for the NFP sector. This document complements our programs and is the outcome of our discussions with members and other interested parties.

Many representatives of the NFP sector told us during the consultation on the first draft of these Principles that access to even more governance resources (e.g. tools, templates, case studies) and references would be valuable. Company Directors is currently developing a range of resources specifically for the NFP sector.

The term "not-for-profit" receives a mixed response from those in the sector. Some have suggested the NFP sector should be called "The Third Sector" or "Civil Society". Others have expressed a preference for "not-for-loss", "for purpose" or "community" organisations. Each of these definitions has its own limitations. Given its widespread usage, the terms "not-for-profit" and NFP will be used throughout this guide.

For ease of reference, the terms "board", "director" and "chair" will be used throughout,

however other terms are prevalent in the sector to describe these roles. They include "committee", "council", "members" and "councillors".

While we firmly believe the Principles provide a useful starting point for the NFP sector on what constitutes good governance, we expect the Guidance (including the commentary, questions and any references) will evolve over time as the NFP sector uses and responds to this material.

Purpose of this Guide

This document sets out some fundamental principles and guidance that can provide a useful framework when considering what constitutes good governance practice (having regard to an organisation's particular circumstances). Commentary is provided under each Principle to help assist organisations seeking to apply these Principles in practice. It is hoped that the material provided will serve as a catalyst for board discussion on governance issues.

The Principles and Guidance:

- Are designed to promote and facilitate the crucial conversations and associated activities NFP organisations undertake regularly to achieve good governance.

- Are not an attempt to formulate rules on what might constitute good governance practice for NFP organisations, or prescribe related behaviours and specific actions.

Applicability of Guide

Our Principles and Guidance should not be seen as a substitute for the relevant laws, regulations and standards which organisations must comply with (these will be different for each organisation's structure and legal jurisdiction).

As there is such diversity of NFPs in the sector, it must be acknowledged there is no "one size fits all" good practice solution for effective governance. Factors which may influence governance arrangements of an NFP include, but are not limited to, the nature of its activities (e.g. complexity, risks, geographical dispersion), the regulatory environment, the legislation that governs the organisation (e.g. the Corporations Act, the various state-based Associations Incorporation Acts), the NFP's constitution and requirements of grantors and funders.

Levels of understanding and how governance is approached will vary according to the purpose, structure, scale and sophistication of the NFP.

As mentioned before, the larger and more mature an organisation, the more likely it will already have adopted comprehensive governance practices and procedures similar to those used by companies listed on the ASX[4]. In saying that, during the consultation, quite a number of participants associated with larger NFPs said they found these Principles and Guidance practical and useful and were already using and referring to them during governance discussions.

Our Principles are designed to assist directors and boards in their conversations on good governance, and how they might practically approach improving governance

outcomes. Naturally, as NFPs grow and mature, their governance thinking and processes will become more refined. As mentioned in the preamble, there are minimum governance standards charities must comply with to be, and remain, registered with the ACNC. These standards reflect a minimum set of outcomes for registered charities.

We trust the Principles and Guidance offered in this document provide the breadth of organisations in the NFP sector with a starting point to discuss and understand what constitutes good governance and take some practical steps on how to foster or enhance good governance in their organisation.

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[4] Including applying many of the ASX Corporate Governance Council's Principles and Recommendations and possibly reporting to interested parties how their approach to governance lines up against them.

TEN PRINCIPLES
THAT PROMOTE GOOD GOVERNANCE

WE BELIEVE THE FOLLOWING TEN PRINCIPLES PROVIDE A USEFUL STARTING POINT FOR NFP BOARDS WHEN CONSIDERING WHAT CONSTITUTES GOOD GOVERNANCE IN AN ORGANISATION'S PARTICULAR CIRCUMSTANCES.

1 ROLES AND RESPONSIBILITIES

There should be clarity regarding individual director responsibilities, organisational expectations of directors and the role of the board.

....

2 BOARD COMPOSITION

A board needs to have the right group of people, having particular regard to each individual's background, skills and experience, and how the addition of an individual builds the collective capability and effective functioning of the board.

....

3 PURPOSE AND STRATEGY

The board plays an important role in setting the vision, purpose and strategies of the organisation, helping the organisation understand these and adapting the direction or plans as appropriate.

....

4 RISK - RECOGNITION AND MANAGEMENT

By putting in place an appropriate system of risk oversight and internal controls, boards can help increase the likelihood that their organisation will deliver on its purpose.

....

5 ORGANISATIONAL PERFORMANCE

The degree to which an organisation is delivering on its purpose can be difficult to assess, but this can be aided by the board determining and assessing appropriate performance categories and indicators for the organisation.

....

6 BOARD EFFECTIVENESS

A board's effectiveness may be greatly enhanced through: careful forward planning of board-related activities; board meetings being run in an efficient manner; regular assessments of board performance; having a board succession plan; and the effective use of sub-committees, where appropriate.

....

7 INTEGRITY AND ACCOUNTABILITY

It is important that the board have in place a system whereby: there is a flow of information to the board that aids decision-making; there is transparency and accountability to external stakeholders; and the integrity of financial statements and other key information is safeguarded.

....

8 ORGANISATION BUILDING

The board has a role to play in enhancing the capacity and capabilities of the organisation they serve.

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9 CULTURE AND ETHICS

The board sets the tone for ethical and responsible decision-making throughout the organisation.

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10 ENGAGEMENT

The board helps an organisation to engage effectively with stakeholders.

....

Each of these Principles is now discussed in detail.

PRINCIPLE 1:
ROLES AND RESPONSIBILITIES

THERE SHOULD BE CLARITY REGARDING INDIVIDUAL DIRECTOR
RESPONSIBILITIES, ORGANISATIONAL EXPECTATIONS OF DIRECTORS
AND THE ROLE OF THE BOARD.

Awareness of responsibilities and expectations

Individual directors are more likely to be effective in their roles when they are clear on their responsibilities and what is expected of them as a member of the NFP's board, including the nature of directors' duties and the operations and finances of the NFP at a level that permits them to govern effectively.

It is inappropriate and unwise to simply have individuals join boards and expect that they should know, "innately" or through "osmosis", what is expected of them and how the board operates. This is particularly the case where an individual is appointed to a board and they have no, or relatively little, board experience, but are drawn to the underlying purpose of the NFP concerned and prepared to serve on a pro-bono basis.

It should be recognised that directors' duties at law may vary from organisation to organisation depending, for example, on the NFP's legal form. There is also sometimes a misconception that serving as a director on a pro-bono basis means that the applicable duties at law are lower than they might otherwise be – this is not usually the case.

Directors serve in a part-time capacity and are not expected to have the same detailed knowledge as management of the operations and finances of an organisation. However, an expectation would usually be that they know enough about the organisation to enable them to govern effectively. Depending on the size of the organisation, director "induction" may range from a detailed introductory conversation with the chair (followed up by a formal letter of appointment) and a meeting with the CEO, through to a documented, detailed, director induction program.

There may well also be an expectation that directors become more heavily involved in fundraising, or matters that are typically the province of management or operational in nature – especially where an NFP is relatively small, or does not have professional management and staff. If there is such an expectation, this should be made clear to a director prior to his or her appointment. A sensible approach to help set clear expectations is for all new directors to receive a 'Letter of Appointment' or engagement (consistent with the organisation's constitution) that sets out details such as:

· How they were nominated/appointed and from what date.

· Their role, responsibilities and duties.

· The term (length) of their appointment and any conditions or limits (e.g. tenure under the constitution).

· Expectations in relation to their governance role, potential advocacy, fundraising and any operational or public profile activities.

· Any induction process (if the NFP is large enough to have one).

Some questions for consideration

· Are the roles and responsibilities of individual directors, the board, chair and management of the organisation clearly set out in the organisation's constitution and/or its governance charter?

· Are board members aware of their duties and what is expected of them?

· Do new board members receive a letter of engagement that sets out their role and responsibilities?

· Do new board members receive an orientation or induction regarding the organisation, their role and responsibilities and conflict of interest parameters?

Clarity concerning the role of the board

For a board to function effectively there needs to be clarity regarding its role. While part of a board's role is to oversee the operations and finances of the organisation, it is usually also externally focused and concerned with the larger context and "settings" of the organisation. Management, on the other hand, tends to focus more on operational detail.

The role of the board usually involves certain core elements, such as:

- Determining, reviewing and maintaining the vision, purpose and values of the organisation.

- Approval of short and long-term strategies.

- Approval of annual budgets.

- Approval of expenditure over pre-specified limits.

- Appointment, performance evaluation and (if the circumstances necessitate) termination of the employment contract of the CEO.

- Risk oversight.

- Providing a check on the integrity of external financial and non-financial reports.

- Any additional monitoring of the activities of the organisation in order to satisfy itself that the NFP is being properly managed.

- Supporting effective engagement with key stakeholders.

The role of management is often described as being responsible for implementing the strategy approved by the board, to get the right results and deliver the right outcomes (depending on the organisation's purpose), without too much direct board involvement.

It may be the case that involvement of the board in organisational activities expands and contracts over time, as the needs of the organisation change. For instance, boards may become more involved in the operations of an NFP in the organisation's early years or where there is period of significant change (e.g. due to an amalgamation of two organisations).

One problem that can arise in some NFPs is the blurring of role boundaries. This can arise, for example, where directors serve in a volunteer capacity and view "stepping in to fill operational gaps" as merely an extension of their volunteering activities. This can create problems from a governance perspective, including the blurring of accountabilities. Directors might be "wearing two hats": as a key operational contributor (like a senior executive), and as a board member. To meet what can be a common challenge of "role confusion", it is vital to remember no matter what else they do, directors still have the same legal duties and responsibilities, and need to govern in the best interests of the whole organisation.

Some questions for consideration

- Does the board have a charter and protocols which help define its role and set out particular types of decisions that are reserved for the board (e.g. by reference to expenditure limit)?

- Do the charter and protocols cover how the chair and the board are expected to interface with the CEO and management?

- Are the chair and CEO roles clearly defined?

- Are there clear documented delegations of authority from the board to the CEO and the management team?

Boards should not function like parliaments

Some organisations seek to have various stakeholder groups (e.g. members nominated by a state) "represented" on the board. This can help to promote an appropriate diversity of views and add to a sense of involvement by those groups "represented". Boards can experience difficulties, however, if individual directors regard themselves only as representatives of a particular group[5]. This can give rise to factions and boardroom infighting, reducing the ability of boards to operate effectively.

It is important to remember that even though a director's appointment may be because he or she is associated with a particular group or might look like they represent certain "constituents", directors must in practice act in the interests of the whole organisation and apply an independent mind to the board's work and decision-making.

[5] Directors of companies have a legal duty to act in the best interests of the company.

PRINCIPLE 2:
BOARD COMPOSITION

A BOARD NEEDS TO HAVE THE RIGHT GROUP OF PEOPLE, HAVING
PARTICULAR REGARD TO EACH INDIVIDUAL'S BACKGROUND, SKILLS AND
EXPERIENCE, AND HOW THE ADDITION OF AN INDIVIDUAL BUILDS THE
COLLECTIVE CAPABILITY AND EFFECTIVE FUNCTIONING OF THE BOARD.

Getting an appropriate mix of skills, knowledge and experience

To be effective a board needs the right group of people, with an appropriate mix of skills, knowledge and experience (e.g. professional backgrounds, industry experience, philanthropic support) that fits with the organisation's objectives and strategic goals. This should be considered not only when new appointments are being contemplated or made, but in the context of regular board evaluations (see below).

Boards which have an appropriate and diverse mix of skills and experience will be less likely to engage in "group think" or to have "blind spots" and they will be better equipped to deliver value and respond to challenges that may arise. The issue becomes, what is the optimal level of "diversity" for a board? This is likely to change from organisation to organisation. Some sets of new skills and experience may add little incremental benefit; others may be of great value. Boards should carefully consider what form and level of diversity is appropriate for their organisation's circumstances. What is clear is that boards should assemble a group of directors that together comprise a range of skills and experience that will best assist the organisation achieving its goals. In doing this there should be consideration given to the former level of diversity that might be appropriate for an organisation's circumstances.

There is often a delicate balance when making board appointments between looking for individuals who will help promote constructive discussion and debate (e.g. to avoid problems associated with group think – potentially an issue with NFPs because they are run by passionate people aligned around a particular cause), but without losing the important board cohesion or collegiate approach to board decision-making. The absence of a collegiate approach to decision-making can lead to highly dysfunctional outcomes, including decision paralysis. As such, personal qualities and behavioural skills are necessary considerations.

A skills matrix

Larger organisations sometimes use a "skills matrix" to help check whether the board has the right balance of people on it, and to assist with selecting new board members. To ensure they possess the right personal qualities, "passion for the cause" and the minimum skills required, such as financial literacy, organisations of scale look at selecting directors who bring skills including:

· Strategic expertise – the ability to guide and review strategy through constructive questioning and suggestion.

· Accounting and finance – the ability to read and comprehend the NFP's accounts, financial material presented to the board (any financial reporting requirement) and some understanding of the organisation's financial drivers/funding and business model.

· Legal – the board's responsibility involves overseeing compliance with numerous laws as well as understanding an individual director's legal duties and responsibilities.

· Managing risk – experience in managing areas of major risk to the organisation.

· Managing people and achieving change.

· Experience with dynamics of fundraising.

· Specific NFP/industry knowledge – passion for the cause, experience in similar organisations, sectors or industries.

The need for other skills, knowledge and experience will depend on the purpose, size and type of NFP, how and where it operates and its activities. The board's needs will alter as an organisation matures and enters a new stage in its lifecycle. When defining needs, consider where the organisation is heading as well as where it is now.

For smaller NFPs where a formal skills matrix process may be too much, it would still be valuable for directors to think about and agree on the type of skills and personal qualities that will meet the NFP's needs. A simple transparent approach for the selection, appointment and re-appointment of directors to the board helps promote confidence among stakeholders as well as an understanding of what is required for potential director candidates.

There is also a need for directors to be able to give sufficient time and effort to their board role, notwithstanding many NFP directors are not paid or receive negligible fees to cover expenses. The desired time commitment required of directors should be considered. The board should consider the number and nature of other directorships and commitments that a potential director has to ensure they can deliver the benefits of their commitment and skills and effectively fulfil their legal duties and responsibilities for the NFP.

Some questions for consideration

- Is there a well-defined and transparent process for board recruitment, including nomination and selection (to the extent that the appointment of directors is within the control of the board)?

- Has consideration been given to how the board is composed (and/or refreshed), including the potential use of tools like a "skills and experience matrix" to ensure the board has directors with:

  - Appropriate skills, capability and capacity, having regard to the organisation, its purpose, operations and its needs.

  - Sufficient diversity of relevant experience and perspective.

- Are potential board members able to commit the time required for their role?

- Should the board have a nominations committee?

- Does the NFP have policies and procedures relating to the retirement or removal (e.g. circumstances in which this can occur) of board members?

The size of the board

The size of a board is a factor that can influence its effectiveness. The main point here is that bigger is not necessarily better.

The constitutions of NFPs often specify a maximum or actual board size. Some constitutions provide for relatively large boards (e.g. ten or twelve directors), commonly with the intention that the board is "representative" of its membership (e.g. geographical representation for federated structures), the community the NFP serves, etc. Those new to directorship may think that a large board offers the opportunity to add a wider array of skills and experience. However, there comes a point where the size of a board becomes unwieldy, difficult to control, and diminishes the board's deliberation and decision-making effectiveness (e.g. speed of decision-making, ability to reach a consensus).

It may be sensible to begin with a relatively small board (for small NFPs, say perhaps four or five directors). As a general guide, the board should, on the one hand, be small enough to have high quality, active discussions, but on the other hand, big enough to provide the skills and experience necessary for the board to operate effectively. It is easier to build up the board than to reduce it once people and structures are in place. Over time, as gaps in the board's knowledge, skills and experience become apparent, particularly as circumstances change, appropriate changes can be made to the board. Ideally this would occur as part of an established process of board assessment and renewal.

Some questions for consideration

· Is the board of a size that is sufficient to enable it to have the necessary knowledge, skills and experience for the organisation, but small enough to enable effective discussion and decision-making?

· Have circumstances changed such that the current size of the board should be reassessed?

Terms of board appointment

Directors of NFPs are sometimes appointed for a term (e.g. three or four years), which may or may not be renewable. Often this will be stated in the NFP's constitution.

As with board size, the optimal board term may well differ between NFPs and over time. If the term of board appointments is too short, this can detract from long-term thinking and board continuity. The longer the term, the more difficult it is likely to be for a board refresh. Normally some degree of flexibility is desirable (e.g. the possibility of a second term), perhaps in well-defined

circumstances, in order to enable valuable contributors to continue on the board for a period. This need for flexibility is particularly relevant for NFPs as they often have specific challenges, including keeping great people and 'representative' boards. For example, it may have taken some time to find and select quality directors and while standard "board refresh" concepts suggest their "time is up", the passion, knowledge and experience and time served by those directors has made them invaluable. Subject to the NFP's constitution, some good contributors may serve terms that are longer than conventional periods.

Care should also be taken to help ensure that individual board terms are appropriately staggered, so that there is a continuity of appropriate knowledge, skills and experience on the board, as well as continuity on organisation and board-specific issues. This reduces the likelihood that multiple concurrent new appointments will impact adversely on the effectiveness of the board [see also, Principle 6].

Some questions for consideration

- What is an appropriate term length in the organisation's circumstances?

- Is there a need for some in-built flexibility to permit valuable contributors to continue on the board beyond the standard term? Are terms of board members staggered in such a way so as not to cause undue disruption to board and organisational activities upon resignation at term completion?

Maintaining a board succession plan

The high turnover on some NFP boards can be an issue for board effectiveness [see Principle 6] and makes it important the board has a well thought through and articulated strategy for its own renewal. It is common practice, for example, for member-based organisations to select some of their directors from those members who have demonstrated a commitment to the organisation's purpose and leadership capability by participating as volunteers on committees.

Boards have to plan for orderly succession and renewal as well as being prepared for everything from sudden departure to sudden illness of a board member or chief executive officer. It is important to understand the disruption which can occur.

Succession planning enables an organisation to refresh its leaders in order to continue meeting its purpose. The aim is to have the right person able to fill the vacancy at the right time. The ongoing nature of this planning means that the board has the opportunity to manage its future needs.

Succession planning is closely connected with the processes for selection, appointment and appraisal of directors and executives. The ASX Corporate Governance Council advises that board renewal is critical to performance and that directors should be conscious of the duration of each director's tenure in succession planning.

The chair and CEO

The chair occupies a pivotal role in determining the effectiveness of a board. The chair, amongst other things, serves as the primary interface between the board and the CEO, presides at board meetings and annual general meetings (where the latter occur), and would typically lead the recruitment of new directors (perhaps in conjunction with a Nominations or Governance Committee).

Attributes of a good board chair would include but not be limited to:

- Provides overall effective leadership to enhance the effectiveness of the board

- Has the confidence of the board

- Has a productive working relationship with the CEO

- Has a good understanding of the organisation's purpose and operational challenges

- Has the skills to ensure the board works as a cohesive team

- Is an effective "conductor" of board meetings [see Principle 6]

A core part of a board's activities involves appointing and supervising the performance of an appropriate CEO. Often the chair will serve as a sounding board for ideas or proposals considered by the CEO. Some circumstances may also necessitate the board terminating a CEO's employment contract.

Some questions for consideration

- Does the chair have demonstrated leadership qualities?

- Does the chair have the confidence of the board?

- Does the chair have the right balance between support and control in their relationship with the CEO?

- Does the chair have the respect of the CEO and management team?

- Has the chair and board agreed a protocol on how the CEO is to interact/interface with the board (taking into account roles and responsibilities have been clearly defined)?

- How effectively does the chair "conduct" board meetings?

PRINCIPLE 3:
PURPOSE AND STRATEGY

THE BOARD PLAYS AN IMPORTANT ROLE IN SETTING THE VISION, PURPOSE AND STRATEGIES OF THE ORGANISATION, HELPING THE ORGANISATION UNDERSTAND THESE AND ADAPTING THE DIRECTION OR PLANS AS APPROPRIATE.

It is critical to define clearly for an organisation:

• Why it exists

• What it does

• For whom it does things

• How it aims to do those things

• How it will measure its success

Answering these questions helps with clarity. Simple statements of purpose will help inform direction and strategy discussions.

The constitution of an NFP (and the objects in it) sets out things a board must do and take into account when it is considering these questions. Organisations should have a clearly articulated purpose with a complementary strategy, which has been endorsed by its board, to deliver that purpose.

Key functions of the board typically include:

• Determining the vision and purpose of the organisation

• Setting strategic organisational objectives aligned with the purpose

• Working with management of the organisation to develop a set of plans that align with the vision, purpose and strategic objectives

• Supporting management in its implementation of the plans

• Monitoring and evaluating the degree of success against these plans and objectives

A vision by its nature is usually aspirational. It sets out what the organisation wants to accomplish into the future, and should be something that inspires members, staff, volunteers, financial supporters and others.

Examples of vision statements include:

• "For Australians to have the best cardiovascular health in the world." (Heart Foundation)

• "To be the leading authority in animal care and protection." (RSPCA Australia)

• "To achieve a cancer-free future for the people of Western Australia." (Cancer Council Western Australia)

• "To be Australia's leading theatre company for young audiences." (Jigsaw Theatre Company)

An organisation's purpose can be described as "what the organisation will do with a view to realising its vision".

Corresponding purpose statements to the above examples are:

• "To reduce suffering and death from heart, stroke and blood vessel disease in Australia." (Heart Foundation)

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

• To minimise the incidence and impact of cancer on our community through advocacy, research, education and by providing people affected by cancer with support to enhance their quality of life." (Cancer Council Western Australia)

• "To create, produce and present new and original work that stirs the imagination of 4 to 18 year olds, tour nationally and internationally, and contribute to the cultural life of Canberra." (Jigsaw Theatre Company)

Vision and statements of purpose go to the heart of many NFPs and as such they are often the product of a collaborative process involving considerable thought and debate. They typically involve discussions among board members, staff and possibly key external stakeholders (e.g. beneficiaries, financial supporters).

It is considered good practice to have an organisation's vision, purpose, strategic goals and plans clearly articulated and outcomes measured in an appropriate and agreed way. However, many NFPs face challenges when attempting to define and measure success. Defining and measuring success can be very difficult conceptually for some NFPs as a result of the nature of their purpose and/or strategic objectives, and require refinement from time to time. For further discussion on performance measures see Principle 5.

It is necessary to periodically review (e.g. every 3-5 years) the organisation's vision, purpose and strategies to determine whether they are still appropriate for the organisation or need amending. Occasionally purposes may be brought into question, for example, because they no longer align with reality, they are unmanageable because of their breadth, or they become impractical. Similarly, the validity of existing strategies may be brought into question, for example, as a result of goals achieved, changing external circumstances and/or in light of past experience.

Another key element of an organisation's strategic planning is the values of the organisation. Values are discussed a little more in Principle 9, where the 'culture' of an organisation is examined.

Some questions for consideration

- Have the vision and purpose of the NFP been well thought through, clearly articulated and set out in the organisation's constitution or other binding charter of existence?
- Have the vision and purpose of the NFP been communicated throughout the organisation and among stakeholders?
- How frequently should the board review the NFP's purpose and strategies to assure their continuing relevance and effectiveness?
- Does the strategic plan align with the NFP's statement of purpose?
- Does the board accept responsibility for the manner in which the organisation is to deliver its purpose?
- Do all the NFP's actions/activities align with its strategy?
- What actions can the board undertake to help ensure the organisation has a clear idea of its vision and purpose and that there is an appropriate set of strategies and plans designed to help achieve these?
- Does the board have time set aside in its yearly calendar for focused strategy development?
- Is strategy alignment considered as a factor in every board decision?
- Does management regularly report to the board on the progress of implementing the strategic plan?

PRINCIPLE 4:
RECOGNITION AND MANAGEMENT OF RISK

BY PUTTING IN PLACE AN APPROPRIATE SYSTEM OF RISK OVERSIGHT AND INTERNAL CONTROLS, BOARDS CAN HELP INCREASE THE LIKELIHOOD THAT THEIR ORGANISATION WILL DELIVER ON ITS PURPOSE.

Risk is another board responsibility, no matter how big or small the NFP. Organisations should establish a sound system of determining risk appetite, oversight, recognition, management, treatment and control.

It is often helpful to think about risk in a strategic and cultural context – getting on top of risk matters will enable the NFP to do the things it needs to do and make it more robust. For many NFPs their ability to achieve their purpose relies upon them showing they have appropriate, effective and current risk management controls, systems and processes in place i.e. they get "accredited" and keep their "license to operate" through appropriate risk oversight.

There may be legal, financial and operational risk compliance obligations linked to NFPs being allowed to operate e.g. for health and/or care providers there are minimum clinical and qualitative standards that must be met and for many NFPs with government funding, robust risk management relating to financial controls are a requirement.

As with all the Principles, approaches to risk will vary according to the purpose, size, structure and personnel running the NFP.

Larger, national NFPs may have acquired or developed a sophisticated risk management program of controls, system and processes with the support of external professional advisors. Tools and methodologies such as *Risk Management – Principles and Guidelines – AS/NZS ISO 31000 2009* are also used by larger organisations to help them with this task.

Smaller local NFP boards with few, if any, staff will apply their own experience, judgement and common sense when thinking about and debating risks and mitigation plans for the NFP. The commentary and questions below outline some fundamentals on risk identification and management as a starting point for NFPs.

Whatever the size and purpose of an NFP, directors showing clear leadership on their responsible approach to risk will have a significant and positive impact on promoting a healthy culture throughout the organisation [see Principle 9].

There is a vast array of risks that NFPs should consider, including but not limited to:

· Staff or employment issues (e.g. wrongful dismissal, harassment)

· Volunteers (e.g. injury to the individuals themselves and/or damage caused to others or property as a result of their inadequate training or screening)

· Physical spaces and equipment (e.g. fire, workplace health and safety issues, theft or misuse, public liability)

· Records (e.g. legal requirements to keep records, confidentiality)

· Cash receipts and payments (e.g. inaccurate records, lack of internal checks and balances)

· Financing (e.g. grant dependent organisations)

It can be helpful to think of risks in broad categories, such as:

· Compliance risks (e.g. failure to lodge statutory information in allowed time)

· Financial risks (e.g. loss of funding, insolvency, expense blow-out)

· Governance risks (e.g. ineffective oversight)

· Operational or program risks (e.g. poor service delivery)

· Environmental, including event risks (e.g. natural disasters and states of emergencies)

· Brand and reputational risks (e.g. due to worsened stakeholder or community perceptions, from major event failure or adverse commentary on performance via traditional and/or digital and social media channels)

· Strategic risks (e.g. stakeholder behaviour change, increased competition for funding)

The number, type and significance of risks vary from organisation to organisation. For example, in the case of an organisation involved with childcare, appropriate screening of staff and volunteers and the health and safety of the environment in which children play are likely to be of importance. For member-based associations, an important risk needing attention might be ensuring confidential information pertaining to members is kept secure.

A conventional approach to risk management (some of which a board may delegate to management, provided there is adequate reporting to and monitoring by the board) would require the board to:

- Identify risks, particularly principal risks, facing the organisation.

- Analyse these risks (What category are they? How likely are they? How material)?

- Establish the organisation's risk 'appetite'.

- Prioritise risks (e.g. by ranking).

- Develop a risk register containing information such as likelihood, materiality and prioritisation.

- Develop and implement strategies to manage the risks, as appropriate, including consideration of:

  - Risk avoidance (e.g. don't do the activity that gives rise to the risk).

  - Risk transfer (e.g. insurance).

  - Risk mitigation (e.g. limits of activity); and/or risk acceptance.

  - Monitor identified risks and how these are being handled on a regular basis.

  - Ensure identified risks are written into the job descriptions of any relevant staff, clearly setting out responsibility and accountability.

- As part of regular reviews, consider whether there are additional risks that need to be assessed and managed, and whether existing strategies to manage risk need to be modified.

A board's oversight of risk may benefit from the establishment of a separate committee or be included in an Audit Committee's responsibilities. If a risk management committee is formed, it should have a clear charter or terms of reference agreed by the board. A common practice would be for the committee chair to report to the full board at the board meeting following each Committee meeting.

Some questions for consideration

- Are there appropriate policies and procedures in place to enable effective oversight and management of risks, including but not limited to identification of principal risks (e.g. on-going funding) and effective management of those risks?

- Does the board devote time in its agenda to consider risks?

- Has the board discussed its risk appetite?

- How often does the board conduct a comprehensive risk governance review (including an assessment of effectiveness)?

- Has management designed and implemented systems to give effect to policies and procedures endorsed by the board, and to periodically report to the board on whether, and the extent to which, those risks are effectively being managed?

- Does the board have access to external professional assistance and advice in identifying and developing strategies to manage and mitigate risk?

PRINCIPLE 5:
ORGANISATIONAL PERFORMANCE

THE DEGREE TO WHICH AN ORGANISATION IS DELIVERING ON ITS
PURPOSE CAN BE DIFFICULT TO ASSESS, BUT THIS CAN BE AIDED BY THE
BOARD DETERMINING APPROPRIATE AND ASSESSING PERFORMANCE
CATEGORIES AND INDICATORS FOR THE ORGANISATION.

Regardless of whether an organisation is "for profit" or "not-for-profit", an important consideration for boards is the degree to which the organisation's available resources are being utilised in an efficient and effective manner to achieve stated outcomes. Is the organisation getting maximum desired impact from and avoiding wastage of precious resources?

Organisations should identify the resources (human, financial, physical and intellectual/intangible) they need to deliver on their purpose and plan how those resources will be made available to and best managed by the organisation.

Once an organisation has decided on its purpose and related strategies (see Principle 3), it is common practice as part of a strategic planning process to choose measures or indicators that enable the board to track progress i.e. the key performance indicators (KPIs) to measure the organisation's performance on execution of its strategy and achievement of its purpose. In this regard, boards need to consider, with regard to the purpose of the NFP, which performance indicators are most appropriate

in the organisation's circumstances (e.g. activities undertaken, grantor requirements, etc), and which indicators should be chosen for measurement purposes. Obviously, it is very important for boards to ensure the metrics adopted are capable of being measured and understood.

There is a wide range of performance indicators used across the NFP sector. Often a board will choose a combination of financial and non-financial metrics.

Financial performance indicators

Table 5.1 provides some examples of financial performance categories and indicators. Of particular note, the threat of insolvency is a very real risk for many NFPs, especially when they are heavily dependent on funding from a limited number of sources. The board will need on a regular basis to satisfy itself as to the financial soundness of the organisation, and obtain information and indicators from management that allow these assessments to be made.

Financial Performance Category	Possible Performance Indicators
Administrative efficiency	Ratio of administrative expenses to revenues Ratio of administrative expenses to total expenses
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 as a result Ratio of fundraising to total expenses
Grant efficiency	Ratio of grant submissions to grants obtained Ratio of grants to total expenses
General financial performance	Revenue growth Working capital ratio

Table 5.1: Examples of Financial Performance Categories and Indicators

Non-financial performance indicators

The nature of many NFPs means that various key performance categories chosen are likely to be non-financial in nature.

There often will be significant qualitative outcomes that go to the heart of whether an NFP is delivering on achieving its purpose and making a difference, for example, has there been a measurable relative reduction in the incidence a particular disease compared with earlier year(s) and do the relevant carers of those suffering feel more supported? Are the children in the school healthier as result of fresh food menu changes in the canteen?

Achieving these outcomes requires rigorous oversight of whether resources are being directed to where they are best applied, so these non-financial performance indicators usually focus on a combination of efficiency (input versus output) and effectiveness (impact) measures.

Efficiency measures can help give a sense of how an organisation is performing and provide a benchmark relative to its peers.

Effectiveness measures might be used, for example, to try gauge the effectiveness of a program[6] or more generally the extent to which an organisation is delivering on its purpose. They can be a lot harder to determine than efficiency measures, are not as readily quantifiable, and involve more subjective judgement.

Category	Measures
Input focused	Number of staff hours on a program Number of volunteer hours donated (e.g. carer hours at premises) Number of full-time employees
Output focused	Number of meals served (soup kitchen) Number of clients seen Number of plays staged (community based theatre) Number of individuals attending course (educational body) Increase in membership numbers (member-based organisation)
Efficiency focused	Cost per meal produced (nursing home) Cost of recruiting per member (member-based organisation) Cost of running course per attendee (educational body)
Effectiveness focused	Number of clients who have received meals Member satisfaction Quality of patient care (clinical improvement)

Table 5.2: Examples of Non-Financial Performance Categories and Indicators

The choice of indicators is likely to vary depending on the purpose and activities of an organisation. For example, a membership-based NFP, might have as one of the metrics relating to outputs, growth in membership numbers, while an organisation that delivers community services, may have as one of its metrics relating to effectiveness, the number of individuals who have received the service.

Some non-financial performance indicators may be necessary for accreditation requirements (e.g. health sector).

Much has been written on the desirable characteristics of measures.

In general, measures should be:

- Meaningful to the organisation

- Capable of being measured and acted upon

- Timely

- Cost effective to produce

- Capable of allowing comparisons (e.g. over different time frames, between projects, with external benchmarks)

- Relatively simple (where possible)

Some questions for consideration

- Is there a clear and agreed view among board members and key stakeholders as to "what success looks like" for the NFP (qualitative and quantitative outcomes)?

- Does management, under the oversight of the board, manage the organisation's resources to ensure their availability for the organisation's needs?

- Does the organisation keep records on its inputs (e.g. volunteer hours) and its outputs (e.g. number of clients serviced)?

- What financial and non-financial objectives have been set by the board? How are these measured and reported?

- Does the NFP have directors capable of assessing both financial and non-financial performance?

- Does management regularly report progress to the board on resource planning and management for the organisation?

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6 For example, what is commonly known as the Logic Model.

PRINCIPLE 6:
BOARD EFFECTIVENESS

A BOARD'S EFFECTIVENESS MAY BE GREATLY ENHANCED THROUGH: CAREFUL FORWARD PLANNING OF BOARD-RELATED ACTIVITIES; BOARD MEETINGS BEING RUN IN AN EFFICIENT MANNER; REGULAR ASSESSMENTS OF BOARD PERFORMANCE; HAVING A BOARD SUCCESSION PLAN; AND THE EFFECTIVE USE OF SUB-COMMITTEES, WHERE APPROPRIATE.

The way in which the board is structured and operates can have a direct impact on the ability of an organisation to meet its strategic objectives.

To improve a board's effectiveness the directors should consider:

· Appropriate board structures

· Planning activities in advance

· Running meetings efficiently

· Assessing board and director performance regularly

· Making effective use of board sub-committees

· Board succession planning [see Principle 2]

Board structures

Subject to their purpose, size and constitution, NFPs should consider the appropriate governance structure for their board to meet their specific needs. For example, whether the NFP would benefit from having a two-tiered structure – with a board of suitably experienced directors being the fiduciary board responsible for governance (satisfying all relevant legal and compliance requirements) and an additional panel of sector/subject matter/industry specialists taking on an advisory role to the board and allowing those individuals to offer their expertise without being concerned about taking on a directors' formal duties and responsibilities.

Some questions for consideration

· Has the board considered how best to meet its needs from a governance and structural perspective?

· Are there technical experts or advisors who may be better suited to sitting on an advisory panel, rather than the NFP board itself?

Careful forward planning of board-related activities

It is common for many boards to use a "board calendar" and have a work plan, whereby important and recurring governance matters are assigned to particular board or board committee meetings. For example, matters such as approval of budgets, a board strategy session, approval of financial statements, CEO performance review and remuneration review.

Many boards also have a program of stakeholder engagement [see Principle 10].

Some questions for consideration

· Does the board have a calendar and work plan covering important and recurring governance matters?

· Does the board schedule discussion on strategy throughout the board calendar?

· Does the work plan allow sufficient preparation time by board committees, management and any advisors supporting them, to achieve calendar deadlines?

Board meetings

Elements of a good board meeting would typically include:

- A clear, concise and focused board agenda, covering the right matters

- Papers delivered in good time (from the CEO and senior management) containing relevant, timely and accessible intelligence in a style and format that enables appropriate analysis

- Prepared participants

- An effective meeting chair

- Relevant, robust and respectful debate

- Minutes that accurately record information and decisions, that are finalised promptly

- Regular in-camera sessions in which non-executive directors meet without executive directors or staff being present

Part of the chair's role would include:

- Having the meeting start and finish on time

- Helping to ensure important issues are included on board agendas and board members have sufficient time to read board papers

- Promoting inclusive debate and an appropriate tone throughout discussions

- Dealing effectively with dissent

Factors that contribute to poor meetings include:

- Poor performance by the chair

- Absenteeism by board members

- Conflict of interest issues not being appropriately dealt with

- Dominant chairs and/or CEOs taking over board meetings/making decisions without sufficient regard for other directors' views

- Board members seeing themselves as representing the interests of a particular stakeholder or group of stakeholders rather than the interests of an organisation as a whole

- Inappropriate agenda and papers (e.g. too detailed or not detailed enough, important information is missing or buried, wrong ordering of items of board papers)

- Not enough time allowed for pre-reading and/or board discussion

Some questions for consideration

- Do board meetings keep to schedule, starting and finishing on time?

- Are items requiring board consideration and approval tabled appropriately?

- Are meeting agendas sufficiently focused?

- Is enough time provided for reading of materials prior to each meeting and for board discussion on items of importance?

- Does discussion occur in a constructive manner?

- Are comments invited by the chair from all board members?

- Is respect and collegiality maintained throughout and between all board meetings?

- Where there is disagreement on issues among board members, how is this handled?

Assessments of board performance

The board should periodically review its effectiveness with a view to taking steps to improve the quality of its governance, boardroom discussion and decision-making. In some cases this review might include use of an external facilitator and a formal board or governance assessment tool. In other cases, this may involve informal one-on-one interviews conducted by the chair, another designated board member or an expert external facilitator (remembering one of the issues being assessed is often the

effectiveness of the chair), supplemented by discussion at a board meeting(s) (typically without management present).

The performance of the board might be enhanced, for example, by:

- A board orientation for new board members
- Mentoring of less-experienced directors
- Allocation of appropriate resources to the professional development of board members

Some questions for consideration

- Does the board evaluate and review the performance of its board members, the board itself and the organisation's key management personnel?
- How often does the board assess its performance and the overall quality of governance?
- Is there a lack of particular skills, knowledge or experience which are needed on the board for it to function effectively? (e.g. industry experience, experience in fundraising, financial literacy)
- What is the process by which the board reviews the skills, knowledge and experience of existing directors and determines any gaps?
- Does the board use the induction process, director reviews and gap analysis to assess continuing professional development needs (relevant to the organisation) and to enhance the relevant skills and knowledge of board members and key management personnel?
- Are board decisions being hampered by a lack of collegiality among board members?
- What steps does the board take to promote a cohesive board team, both as part of a regular performance assessment and for new board appointments?

The effective use of sub-committees, where appropriate

Sometimes it makes sense for the detailed work of boards to be considered by board committees. Board committees can play a key role in assisting the board to fulfil its corporate governance responsibilities, and provide a vehicle for enhancing the participation of non-executive directors. In particular, board committees can help to:

- Pay more detailed attention to designated areas that is not feasible in a full board meeting.

- Share the workload among board members.

- Address potential conflicts of interests (e.g. consideration of executive remuneration when there are executive directors).

- Streamline full board meetings and thereby enable the board to function more effectively.

Importantly, the use of board committees does not diminish the responsibilities of those board members who are not on the sub-committee. The matters considered by a board committee remain decisions of the board for which the entire board must take responsibility.

The appropriate number and type of board committees varies based on issues such as organisational size, complexity of operations, the organisation's constitution, and regulatory or grantor requirements.

Common board committees include, but are not limited to a:

- Nomination, governance or human resources committee

- Remuneration committee

- Audit committee

- Risk committee

- Investment committee

- Fundraising committee

Where board sub-committees are formed they need, among other things, clear terms of reference, and ideally a regular review of the ongoing need for such a committee and its charter.

Some questions for consideration

- Consistent with the NFP's constitution and structure, in what areas (e.g. board nominations, audit, remuneration, risk, fundraising), if any, might governance be enhanced through the use of board sub-committees?

- Do existing board committees have clear terms of reference?

- Is there a process by which the chair of each board committee reports back to the full board regarding the activities of the committee?

PRINCIPLE 7:
INTEGRITY AND ACCOUNTABILITY

IT IS IMPORTANT THAT THE BOARD HAVE IN PLACE A SYSTEM WHEREBY:
THERE IS A FLOW OF INFORMATION TO THE BOARD THAT AIDS
DECISION-MAKING; THERE IS TRANSPARENCY AND ACCOUNTABILITY
TO EXTERNAL STAKEHOLDERS; AND THE INTEGRITY OF FINANCIAL
STATEMENTS AND OTHER KEY INFORMATION IS SAFEGUARDED.

Appropriate and timely information

Essential to good governance is an effective working relationship between the chair, directors, the CEO and other senior management. It is critically important that there is a clear understanding of and agreement on:

· Roles and responsibilities

· The required mix of directors

· How effectively the board operates

· How effectively the board interacts with management

· The board's accountability to its constituents

· Directors' accountability to one another

A foundation of a healthy board and management relationship is the content and quality of the information that meets the board's reasonable expectations. For directors to fulfil their role and carry out their responsibilities with integrity and ensure appropriate accountability, they need to have current and relevant reports containing information of the type described below.

The "health" and performance of the organisation are critical items for the board to be focusing on as part of its regular monitoring. It is generally regarded as useful for boards to have a report from management at each board meeting that, among other things, gives a good sense of:

· How the organisation is tracking against its purpose and plans; the financial health of the organisation

· Major strategic project reports

· Material risk updates

· Any important regulatory, compliance and reporting obligation matters

The degree of structure and detail relating to such reports will depend on the size, nature and complexity of the NFP's operations. In relation to "financial health", directors of smaller NFPs should expect to see basic items such as expenditure against budget, cash flow projections and a current balance sheet at a minimum. Larger NFPs may require an internal audit function (see below) that works with the board-appointed sub-committee, the audit committee.

A challenge for boards in this regard will be to determine, in consultation with management, a set of metrics that serve as a "dashboard" or indicate how the organisation is performing. [see Principle 5]. As the name suggests, a "dashboard" permits directors to get a sense of the organisation's progress against KPIs at a glance. "Dashboards" are often created to give a visual representation of the executive summary of sometimes large amounts of supporting information e.g. a coloured pie-chart reflecting the type of financial performance indicators (ratios) described in Table 5.1 [see Principle 5] or on a project or risk update, management might use a simple "traffic light" system (coding of red, green and yellow) to represent how well things are progressing on important elements of the project.

Dashboards may also be of value to illustrate the organisation is meeting any fundamental regulatory, compliance and reporting obligations associated with any "accreditation" or "license" requirements linked to what they do.

> **Some questions for consideration**
>
> · Is the board provided with key metrics or a "dashboard" as to how the NFP is performing relative to KPIs and stated objectives generally?
>
> · Is the board provided with sufficient information to assess the financial and non-financial position and performance of the NFP?
>
> · Is the board provided with relevant, timely and accessible updates and intelligence in a style and format that enables ready understanding and appropriate analysis?
>
> · Does the board require management to update directors on the status on risk issues and the organisation's regulatory compliance and reporting obligations?
>
> · Does the board have sufficient financial skills?

Communicating performance against purpose

As mentioned above, it is important that the board have in place a well thought through and clearly articulated purpose that is communicated effectively, both within the organisation and externally.

External financial reporting

Organisations should seek to ensure that their financial standing is sound and that their systems of financial reporting and assurance have integrity.

The level of financial reporting NFPs undertake can vary significantly from organisation to organisation. Some NFPs, particularly larger charities, will prepare full audited financial reports. Other organisations might instead have their reports "reviewed" rather than "audited". Some may prepare "special purpose" financial reports as opposed to "general purpose" financial reports.

No matter what financial reporting requirements an NFP is subject to, the board plays a role in helping to ensure the integrity of the financial reports. The board should accept responsibility for overseeing the integrity and assurance of the organisation's financial position, performance and reporting.

Activities that boards might undertake to help promote the integrity of financial reports include:

· Having an appropriate level of financial literacy at board level

· Establishing an audit committee[7]

· Establishing an internal audit function

· Drawing on external financial expertise (e.g. voluntary audit or review)

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[7] Auditing and Assurance Standards Board, Australian Institute of Company Directors and the Institute of Internal Auditors-Australia, *Audit Committees: A guide to good practice*, 2012.

PRINCIPLE 8:
ORGANISATION BUILDING

A BOARD HAS A ROLE TO PLAY IN ENHANCING THE CAPACITY
AND CAPABILITIES OF THE ORGANISATION THEY SERVE.

A fundamental part of the board's role in serving the best interests of the organisation is to ensure the organisation develops and implements strategies and supporting policies to enable it to fulfil its purpose consistent with the objectives set out in the organisation's constitution. While the board delegates the day-to-day management of the organisation to executives, directors remain accountable for the NFP's performance i.e. the board has its strategic and monitoring role, while also continuing to offer support to management, staff and any volunteers.

Generally speaking, organisations should identify the resources (human, financial, physical and intellectual/intangible) they need to deliver on their purpose and plan as to how those resources will be made available to, and best managed, by the organisation.

Accordingly, one of the matters a board will need to address as part of its overall leadership role is the capacity and level of capability of the organisation to deliver on its purpose. Capacity in this context refers to volume (e.g. is the organisation of sufficient scale?), while capability refers to skills to get the job done (e.g. does the organisation know how?). "Capabilities" and "competencies" are words regularly used by human resources' professionals and other management in larger organisations. For smaller, more informal groups, simply putting it in a "skills" context might be helpful.

The board might think about issues including:

- What are the strongest skills represented within the organisation/team/amongst volunteers?

- Are there any skills gaps?

- What are the organisation/team/volunteers known for doing well?

- Do the current employees/team members/volunteers have the ability to do the jobs/tasks required?

- How are those skills monitored and assessed?

- If there are gaps or needs, how do we go about supporting improvements/acquiring them?

Considerations in this regard include:

- The capabilities of the CEO and the management team

- The knowledge, skills and experience that reside with the board

- The financial resources available to the organisation

- The degree to which the culture and behaviours necessary to execute current strategies and deliver on purpose are present

In some cases, a choice may need to be made whether to try increase an organisation's capability to deliver on its stated purpose and strategies, or to alter its purpose and/or strategies.

Actions a board might consider, depending on the circumstances, include:

- Mentoring of the CEO and junior board members

- Professional development of board members

- Focusing on how success is rewarded or celebrated

CEO appointment

The appointment of a chief executive officer (CEO) or equivalent is a critical factor to the success of an organisation. A core part of a board's activities involves appointing and managing the performance of an appropriate CEO, and possibly overseeing the appointment of other senior executives. As the leader of the team executing the strategy, the value of the CEO to the organisation cannot be underestimated. Ideally, the board and CEO are in a mutually dependent partnership.

Accordingly, governance experts suggest a board should look for collaborative traits when selecting a new CEO. Consistent with this, experts often advise boards to avoid CEO candidates who give the impression that they see the board as an entity to be "managed" rather than a body to which they are accountable. Collaboration with the board could even be built into a CEO's job description as a KPI and feedback provided regularly.

CEO succession planning is another important aspect of the board's role. The needs of an organisation will change over time and a CEO who is an excellent appointment today and in the short term may not be the best

person later. For example, an organisation undergoing a period of major change or regulatory reform can benefit from a CEO with skills and experience in this area, but the organisation may require a CEO with a different skill set when the period of major change is over and the circumstances are more settled.

Human resources policy

A matter of focus by many boards is how their organisation is able to attract and retain individuals with necessary skills and experience, and often with limited financial benefits to offer such individuals. In the NFP sector it may be the potential management, staff and/ or volunteers are passionately committed to the cause or central activity of the organisation and want to be involved and help. Goodwill and conviction may not always be enough to get and keep the type of skills required, so many boards devote time, in conjunction with management, to developing policies and plans as to how the organisation will access resources to build and sustain its organisational capacity and capability.

Use of volunteers

There are a large number of NFPs that are sustained by the involvement of volunteers, including at the board level. This often involves a level of commitment by the individuals concerning the underlying purpose of the organisations. The combined contribution of volunteers can represent a valuable and sometimes critical resource for NFPs.

Subject to what the NFP does and how it engages volunteers, with the immense benefits of having access to them comes some matters that need to be addressed.

Some of the things that might require consideration include:

· Providing relevant training

· Workplace health and safety issues

· Checks, clearances and references

Some questions for consideration

· Does the board have the right set of skills, knowledge and experience to deliver on its purpose and execute its strategies and how often does it conduct a review?

· Does it have the right CEO and management team?

· Is there an appropriate succession planning process in place for the CEO and senior managers?

· Does management regularly report to the board on resource planning and management for the organisation?

· Does the board have a clear and current policy on volunteers?

· Have comprehensive volunteer practices and procedures been prepared by management and endorsed by the board?

· Does the organisation have the necessary financial resources to support vital skill development and retain the people with the right skills?

PRINCIPLE 9:
CULTURE AND ETHICS

THE BOARD SETS THE TONE FOR ETHICAL AND RESPONSIBLE
DECISION-MAKING THROUGHOUT THE ORGANISATION.

The culture of an organisation could be thought of as its "personality". It is represented by shared values, norms, practices and core beliefs that shape behaviour. Organisational culture is sometimes described as "how we do things around here".

The culture of an organisation therefore influences what it does, its relationships with stakeholders and its reputation. It can also be an important determinant of whether the organisation is able to achieve its strategic objectives and deliver on its purpose.

While culture can be a complex and elusive thing to identify and improve, it can have a direct impact on the activities and success of an organisation. For example, through the effect it has on the level of staff morale, absenteeism, the ability to attract or retain staff, the level of "wastefulness", the level of risk-taking (including reputational risk) and the potential exposure of the organisation to legal or regulatory action.

A board and its individual members have a leading role to play in promoting a healthy culture for the organisation they serve. Clearly the chair has a leadership role in this context to set the standard for others to follow in terms of culture. Some would go as far as to say that boards can ill afford to ignore cultural considerations because, whether through conscious actions or otherwise, the culture and ethos of an organisation will be heavily influenced by what happens at the board level.

Recognising the relationship between culture and strategy, many boards take a conscious and active role, both at a board and an organisation-wide level, in promoting the culture and behaviours necessary to deliver on purpose.

Board culture

It is widely recognised that the culture of an organisation will be influenced by the conduct and actions of the board and individual directors. To repeat an ancient Chinese saying, "the fish rots from the head"[8].

Some organisations set out elements of expected conduct and ethical standards in "codes of conduct". One area of particular focus has been to put in place arrangements aimed at having potential conflicts of interest dealt with appropriately, including policies and procedures concerning the identification, declaration and management of conflicts.

Every decision made by a board must be impartial and in the best interests of the organisation. If a particular decision is likely to benefit a director in some way, or benefit someone close to a director, that director is no longer in a position to make an impartial decision; he or she has a conflict of interest.

Generally speaking, the principles of managing conflicts are fairly clear: if a conflict has been identified, it must be disclosed and from the moment it is disclosed, that director is no longer invited to exercise judgement on how it should be resolved. The other members of the board should then decide the best course of action. The director with the conflict may be excluded from any further discussion or be allowed to be present, but not permitted to vote. The board may also tailor the papers provided so that the conflicted director receives no information on the issue.

Having clear codes around potential conflicts and other conduct and ethical standards sends a message to the organisation and all those who have dealings with it that the board is committed to upholding certain standards, and is transparent about what it believes is appropriate behaviour.

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[8] Refer to Bob Garratt, *The Fish Rots From The Head: The Crisis in our Boardrooms: Developing the Crucial Skills of the Competent Director*, Profile Books, 2nd edition, 2003.

Many desired behaviours that promote a healthy culture in the boardroom are often unwritten, such as:

· Arriving at board meetings on time and staying until the meetings end

· Reading board materials in advance of meetings

· Not talking over others or monopolising board discussions

· Giving each board member the opportunity to speak

· The asking of questions not being discouraged or frowned upon

· Board issues being dealt with in the boardroom and not "in the lift lobby" or externally

A well-functioning board will necessarily entail a high-level collegiality and mutual respect, but at the same time recognise the need for constructive discussion and debate where appropriate.

Some questions for consideration

· Has the board developed a code of conduct and agreed set of values and behaviours to guide board members?

· How does the board hold itself accountable for compliance with the formal code of conduct and ethical standards?

· Does the board hold itself accountable to its own code of conduct?

· Does the chair proactively lead board culture and ensure the active engagement of all directors?

· Does the chair have the confidence of key stakeholders?

· Is there a formal policy relating to the declaration and handling of conflicts of interest?

Organisation-wide focus

The board can take steps to influence organisational culture to enable it to more effectively implement its strategies and deliver on its purpose. This might include examining existing culture and how this differs from desired culture, then prioritising any desired changes and putting in place an action plan to bring these changes about.

Implementing cultural changes is not usually a simple or straightforward process. It can involve the re moulding of values, beliefs and behaviour, and necessitate a considerable time commitment, particularly from management and staff.

Measures that organisations might use to help influence culture include:

· Encouraging and facilitating open conversations on the values of the organisation

· Developing or adapting a formal code of conduct and ethical standards

· Challenging undesirable practice and behaviour

· Undertaking team-building exercises

· Training and support

· Reviewing hiring and firing practices

· Changing how success is rewarded/celebrated

Some questions for consideration

· Does the organisation have a formal code of conduct and ethical standards?

· How does the board hold management accountable for compliance with the formal code of conduct and ethical standards?

· To what extent has the board considered "the way things are done", in terms of potential impact on the ability of the organisation to execute its strategies and deliver on its purpose?

PRINCIPLE 10:
ENGAGEMENT

THE BOARD HELPS AN ORGANISATION TO ENGAGE EFFECTIVELY
WITH STAKEHOLDERS.

Who are stakeholders?

A person, group or organisation that has interest or concern in your NFP. Stakeholders can affect, or be affected by, the NFP's actions, objectives and policies.

Some examples of key stakeholders are the people and/or groups served by the NFP, donors, creditors, directors, employees, volunteers, government (and its agencies), members, other related institutions, suppliers, volunteers, unions and the broader community.

What is stakeholder engagement?

The interactions that an NFP has with its stakeholders, including the communication by stakeholders of their views to the board and by the board of its perspectives to stakeholders.

What is effective stakeholder engagement?

Successful stakeholder engagement requires a commitment to engage actively with stakeholders; listen to them, talk to them about why your organisation exists, what it does and build a relationship with them in a mutually beneficial way. Engagement is not an end in itself, but a means to help build better understanding and relationships with the individuals, groups, departments or other entities with whom the NFP intersects.

Why does it matter?

Better stakeholder engagement has the potential to provide useful information to the board (e.g. how the NFP and its purpose are perceived, possible funding risks or opportunities, strengths and weaknesses, potential strategies), improve the NFP's relationships with its stakeholders (e.g. build goodwill, address potential issues), and increase the likelihood that the NFP is able to deliver on its purpose. Accordingly, if they have any impact on achieving your objectives, it is important to work out who your stakeholders are, understand what matters to them and why, then connect with them effectively.

Engagement with key stakeholders can be particularly important when setting or considering changes to the purpose of the organisation. In short, it is important for organisations to respect the rights of members (who may control and vote on key NFP matters) and engage and communicate effectively with all other relevant stakeholders

Communication

Good two-way communication to and from the board, which is transparent and provides clarity, is often key to effective stakeholder engagement.

By definition, NFPs basically start with a good reputation: whatever their vision and purpose, they are acting in the interests and for the benefit of others. This is true whether discussing a small community sporting organisation or a large national icon seeking to combat a widespread disease or condition.

Reputation can be described as the sum of perceptions about an organisation (and its

people and actions) held by the people with whom the organisation intersects in the areas where the organisation operates i.e. their stakeholders.

While an NFP may be performing very well and working solidly to achieve its purpose, perceptions regarding its efforts may not reflect that truth, and it may not enjoy the reputation it deserves. It can be as simple as influential people being unaware of the good works or having an uninformed perception. Practically, this may mean a potential contributor, benefactor or relevant government body is not in a position to assist or offer advice purely because they are not sufficiently acquainted with what is going on.

At a minimum, good practice would usually include the annual report setting out the extent to which the organisation has achieved its stated objectives in a way that people with an interest in the NFP should be able to understand. Obviously there are more potential opportunities for the NFP to connect with stakeholders through many other channels.

For larger NFPs, a formal communication strategy or more detailed stakeholder analysis and engagement program may be formulated. In this context, there may be opportunities for directors to be effective advocates on behalf of the NFP, subject to what the board endorses, and relevant codes of conduct etc. An example of where the board might think this type of engagement approach has merit is where an NFP has some reliance on a particular government policy or agency and the potential consequences of any changes and environmental shifts have not necessarily been understood. Directors' participation in a simple briefing may prove to be an effective way to promote clarity and better understanding. Similarly, directors'

participation in community meetings, for example, may promote confidence and accelerate the achievement of goodwill not easily achieved by the best written communication.

For smaller NFPs, an example of this form of stakeholder engagement may be as simple as a director keeping an open dialogue with the relevant governing body of a federated association with which the NFP is affiliated. This would enable that director to report back to the board on any relevant matters.

Some questions for consideration

- Has the NFP identified its key stakeholders and current relationships?

- Has the board considered and articulated its approach to stakeholder engagement?

- Has the board developed policies and practices for the organisation to:

  - Effectively engage with members and stakeholders?

  - Transparently communicate with members and stakeholders?

  - Facilitate the exercise by members of their member rights?

  - Encourage member participation and voting at member meetings?

- Is there a periodic assessment by the board as to how the NFP engages with key stakeholders?

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