AUSTRALIAN INSTITUTE *of* COMPANY DIRECTORS

2015

NFP GOVERNANCE AND PERFORMANCE STUDY

Australia's most comprehensive governance research

CommonwealthBank

BaxterLawley

Commonwealth Bank – Supporting social impact

The Commonwealth Bank's Social Impact Banking team is delighted to once again support the Australian Institute of Company Directors' 2015 NFP Governance and Performance Study.

The not-for-profit (NFP) sector is an essential part of the Australian economy and society and continues to deliver benefits to our community more efficiently and effectively than ever before. Nevertheless, financial sustainability remains the key issue for directors of NFPs and is the driving force behind issues of efficiency, strategy, mergers and collaboration.

A complex web of factors influence the financial health of organisations – it's not simply a case of fundraising, as is so often perceived by wider Australia. Interestingly, this year's study demonstrates emphasis on simple cost management as an imperative has diminished and NFPs' focus is evolving to encompass a richer mix of diversifying income streams and increasing own-source income.

In our own close work with those at the helm of financial management we have seen an increasing shift towards the creation of social enterprises within NFPs. Innovative internal profit-making activities and methodologies, designed to raise both funds and awareness in support of organisations' overall missions, form just one approach to improving financial sustainability.

In last year's study, we saw that mergers were increasingly being discussed. This year, that trend continues and actual mergers are becoming more common. However, directors warn that mergers should not be viewed as a panacea.

There are a range of alternative approaches that financially responsible directors can adopt on behalf of their organisations. Collaboration and joint ventures are becoming more common for NFPs and many are broadening their range of revenue sources to expand funding, eliminate the risk of single-source revenue and continue to grow. Transferral of assets and services to other NFPs with similarly oriented missions is also a consideration for some.

Overall the quality of governance continues to improve. An increasing emphasis on clarification of an organisation's direction from a strategic perspective and an increase in financial management capabilities are key factors.

Commonwealth Bank is absolutely committed to the social impact sector and building financial capability in Australia's NFPs.

Our support of this study forms part of this commitment. We trust that you find it thought provoking and of benefit and we look forward to working with many of you in the year ahead.

Vanessa Nolan-Woods
General Manager, Social Impact Banking, Commonwealth Bank

commbank.com.au/notforprofit

CommonwealthBank

Contents

Foreword by John Brogden AM FAICD

Welcome to the 6th annual NFP Governance and Performance Study.

The Australian Institute of Company Directors is committed to supporting not-for-profit (NFP) directors and boards to be their very best.

Over the past few years we have increased our range of services and tools to support the NFP sector, including the creation of this study, which is now the largest of its kind in Australia.

We have also recently appointed an NFP Sector Leader who will help drive even further focus on our offerings in the NFP sector. The focus of the role is to work closely with NFP organisations to achieve better outcomes through enhanced governance. This includes advocating on the issues important to the sector, ensuring our education programs maintain their relevance and developing practical tools and resources for use.

We see this study as a critical part of our ongoing commitment to the sector. This year the online survey had close to 3,000 respondents and we held discussion forums in Sydney, Melbourne, Perth, Canberra, Hobart and Launceston.

We understand the sector is incredibly diverse and, as such, governance structures and practices will differ.

This year we examined new issues, including the challenges for directors of arts organisations, as well as governance in federated structures.

A key theme emerging from this year's study is the need for a more mature relationship between governments and the sector. As governments continue to rely on the sector for the delivery of critical services, a strategic partnership is required to ensure long-term sustainability of these services.

We hope you find the 2015 study valuable.

John Brogden AM FAICD
Chief Executive Officer & Managing Director

Executive summary

The 2015 study again highlighted many of the challenges facing the NFP sector, and not surprisingly there was consistency from previous studies.

Financial sustainability continues to be a top priority for NFP organisations. While government funding is a key element of this, there is also recognition that many organisations will need to change their business models to ensure their long-term viability.

Mergers and collaboration continue to be a hot topic for directors and boards. Importantly, mergers are not only being discussed by boards – they are actually happening. Directors provide a word of warning though: "mergers are not the solution to every problem".

Directors are calling for a more collaborative relationship with government. This isn't just in terms of funding arrangements, but more importantly, there is a desire to work in "partnership" mode with governments across Australia to help solve the big issues facing our society.

This year for the first time we shine a light on the governance practices and challenges of arts and cultural organisations.

What we discovered is that arts organisations had a greater focus on diversifying income sources, particularly from corporate philanthropy. This is largely due to the recognition that government funding will continue to decline.

And finally, there is no doubt that governance in the NFP sector continues to evolve and mature.

While this can be said of all sectors, the NFP sector continues to shake off the perception that its governance is poor, and in many aspects could be leading the way, particularly in the area of board diversity.

Key sector events in 2014-15

The number of NFPs remains constant, but their importance in the economy has grown – The number of 'economically significant' NFPs in Australia (i.e. those with annual revenue over $50,000) has remained roughly constant at approximately 57,000, but their contribution to the economy (gross value added) has increased by 42% in real terms over five years to June 2013. NFPs now employ over 1m Australians – 8% of the total workforce.[1]

Ninety per cent of charity income (approximately $90b) was earned by approximately 2,600 (10%) of charities.[2]

Three social services ministers in a year – Under the new Turnbull government, Christian Porter became Minister for Social Services in September 2015, replacing Scott Morrison, who had been in the role for only nine months. Morrison had replaced Kevin Andrews, who held the portfolio for just over a year.

The ACNC looks set to stay – The Australian Government's budget papers made provision for funding the Australian Charities and Not-for-profits Commission (ACNC) until 2019, providing evidence that the charity regulator is here to stay. Charities will continue to be required to submit annual information statements providing operational and financial data to the ACNC.

NFP tax reform and competitive neutrality back on the agenda – The Treasury launched its tax white paper entitled "Re: Think: Better tax, better Australia". It raised questions about whether the current tax arrangements are appropriate, impact competitive neutrality with regard to the for-profit sector, should be simplified, or could be changed to enable NFPs to deliver benefits to the Australian community more efficiently and effectively.

The Treasury released an exposure draft regarding changes to Fringe Benefits Tax concessions on salary packaged entertainment benefits to $5,000.

Reduction in Commonwealth funding and procurement reform is having a deep impact on human services – The Commonwealth Government announced it would reduce funding to community services by $1b over four years. The Department of Social Services' "open tender" process saw cuts of $240m, and was criticised for being disorganised and creating significant uncertainty for NFPs. Several services that were defunded or received significant cuts later had their funding restored.

The Budget also included the diversion of $104 million from the Australia Council for the Arts to a new National Program for Excellence in the Arts (NPEA) fund. This decision was criticised across the arts sector.

The impact of individualised funding is being felt by a large number of NFPs in human services – The policy shift towards individualised funding of human services, most notably with the National Disability Insurance Scheme, but also in other areas, continued to have a deep impact. It is still well supported, but its implementation began to create challenges for both NFPs and governments.

1 ABS Cat. No. 5256.0 - Australian National Accounts: Non-Profit Institutions Satellite Account, 2012-13

2 Knight P.A. and Gilchrist D.J. 2013 (2014) Australian Charities 2013: The First Report on Charities Registered with the ACNC, A Report for the Australian Charities and Not-for-profits Commission, Melbourne.

Key findings

1. Financial sustainability remains *the* key issue
2. Mergers are not just being discussed – they are happening
3. NFP directors want a more collaborative relationship with the government
4. NFP governance continues to evolve and mature
5. NFP boards are leading diversity
6. Directors' contribution: donating money *and* time?
7. Culture and the arts – balancing on a tightrope
8. Federated organisations – full of complexities

1.

Financial sustainability remains *the* key issue

Financial worries continue

The 2015 study found that building financial sustainability is still the major concern for most directors.

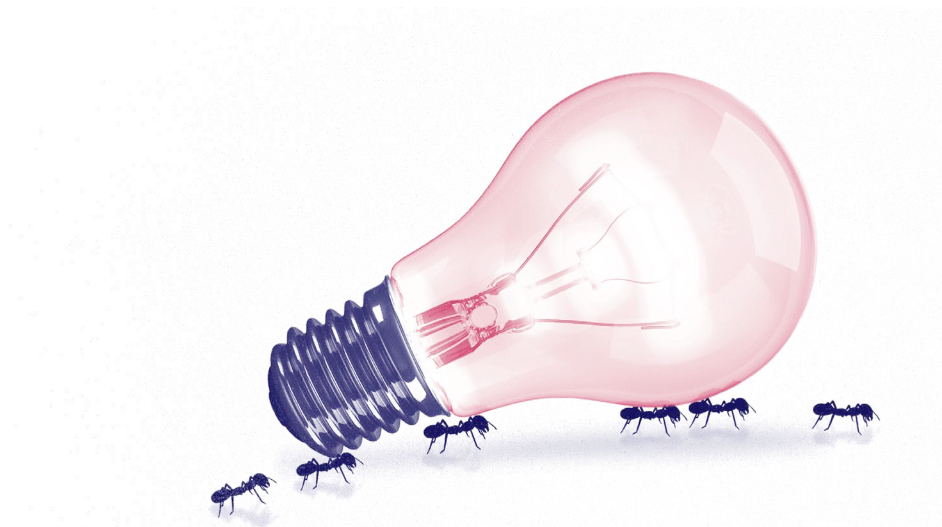
The on-going pressures on financial sustainability affected responses to many questions raised by the study, including the issues of NFP efficiency, mergers, collaboration and closure. Four of directors' six highest-rated priorities related to the issue of the organisation's financial health. These included maintaining or building their NFP's income, diversifying income sources, increasing own-sourced income and managing costs. Nearly half of all directors also believe that clarifying their organisations' strategic direction is a high priority and 37% believe that their NFP needs to focus on responding to changes in government policy.

NFP efficiency – our results might challenge your assumptions

The question of NFP efficiency created some interesting debates in the focus groups we held across Australia with NFP directors. It also elicited many comments from our survey respondents.

There is a widely held view that NFPs are inefficient in comparison to for-profits. In its 2010 report titled "Contribution of the Not-for-profit Sector", the Productivity Commission stated "the concept of productivity is alien to many NFPs" and "some NFPs have a different conception of efficiency and effectiveness, or may eschew such notions altogether".[3] This report repeated public perceptions and has been influential in shaping opinions.

However, neither the Productivity Commission nor others since have provided evidence that NFPs are less efficient than for-profits in delivering services. To examine directors' beliefs regarding NFP efficiency, this year we asked respondents to rate the efficiency of their NFP and also their opinion of the efficiency of the NFP sector in general.

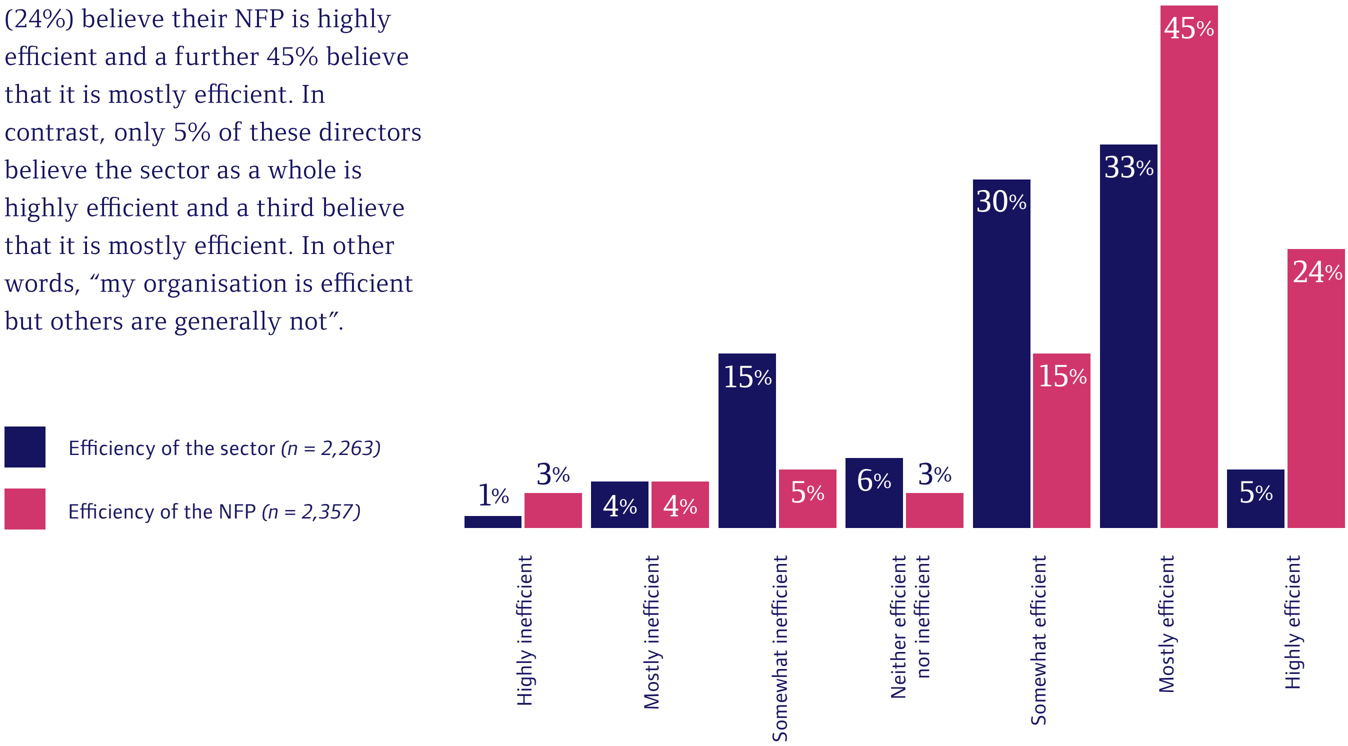


3 Productivity Commission 2010, Contribution of the Not-for-Profit Sector, Research Report, Canberra.

My organisation is efficient, but the sector is not

Nearly a quarter of all directors (24%) believe their NFP is highly efficient and a further 45% believe that it is mostly efficient. In contrast, only 5% of these directors believe the sector as a whole is highly efficient and a third believe that it is mostly efficient. In other words, "my organisation is efficient but others are generally not".

Directors' opinion of the efficiency of their NFP and the efficiency of the sector



This is the first time research of this kind has been published and these results raise some important questions for governments, the sector and boards.

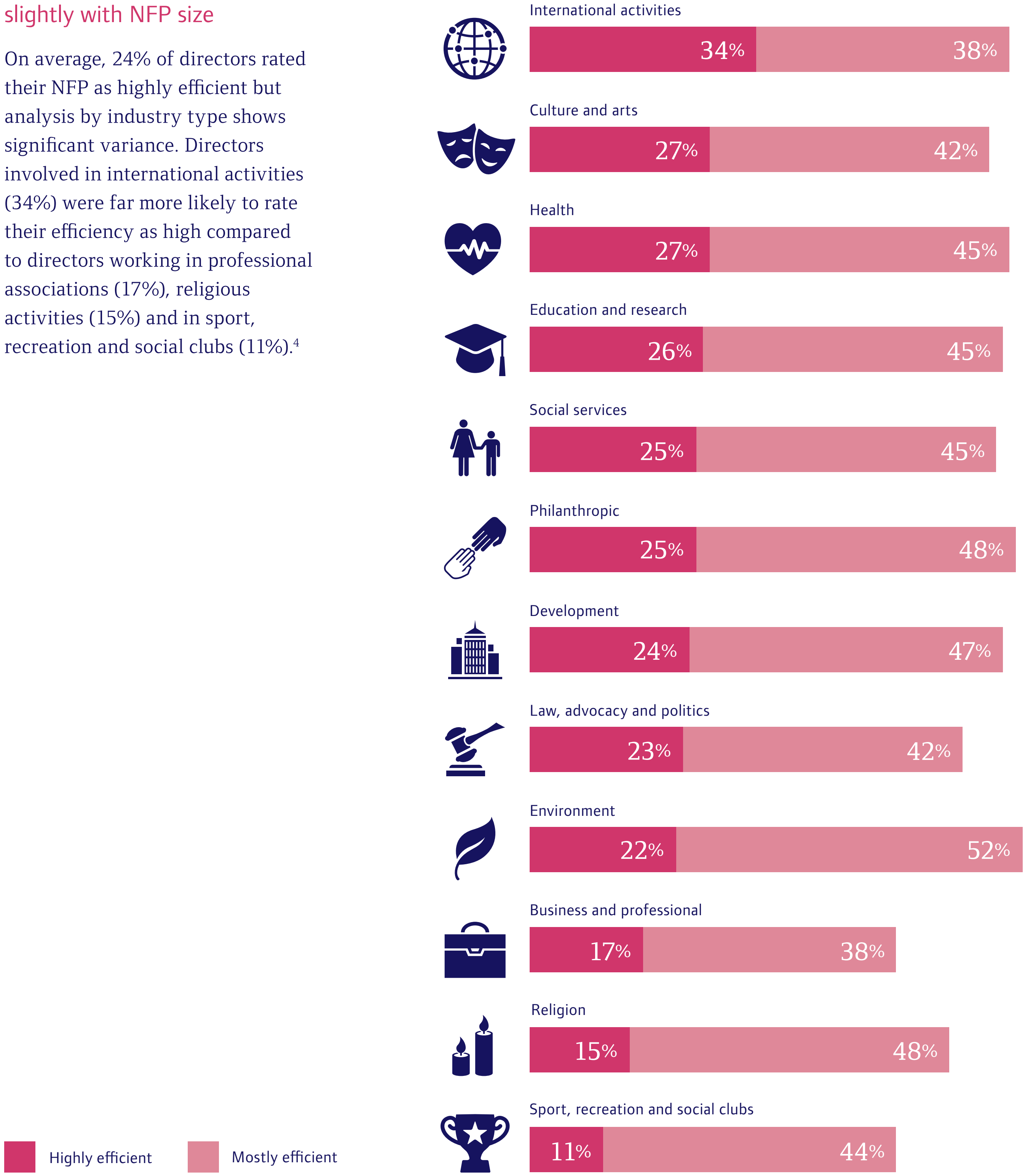
It is evident that perceptions of low levels of NFP efficiency underpin government policies across a range of areas including taxation, contracting and grant-making policy. In particular, recent comments and questions raised regarding tax and the National Disability Insurance Scheme presuppose that opening markets to competition will improve service and reduce costs. If this assumption is not correct, there could be significant consequences for both service users and government budgets.

It is therefore vitally important for governments to test assumptions about NFP efficiency in detail and across different sectors when making policy changes.

Views of efficiency ratings vary across industries but only slightly with NFP size

On average, 24% of directors rated their NFP as highly efficient but analysis by industry type shows significant variance. Directors involved in international activities (34%) were far more likely to rate their efficiency as high compared to directors working in professional associations (17%), religious activities (15%) and in sport, recreation and social clubs (11%).[4]

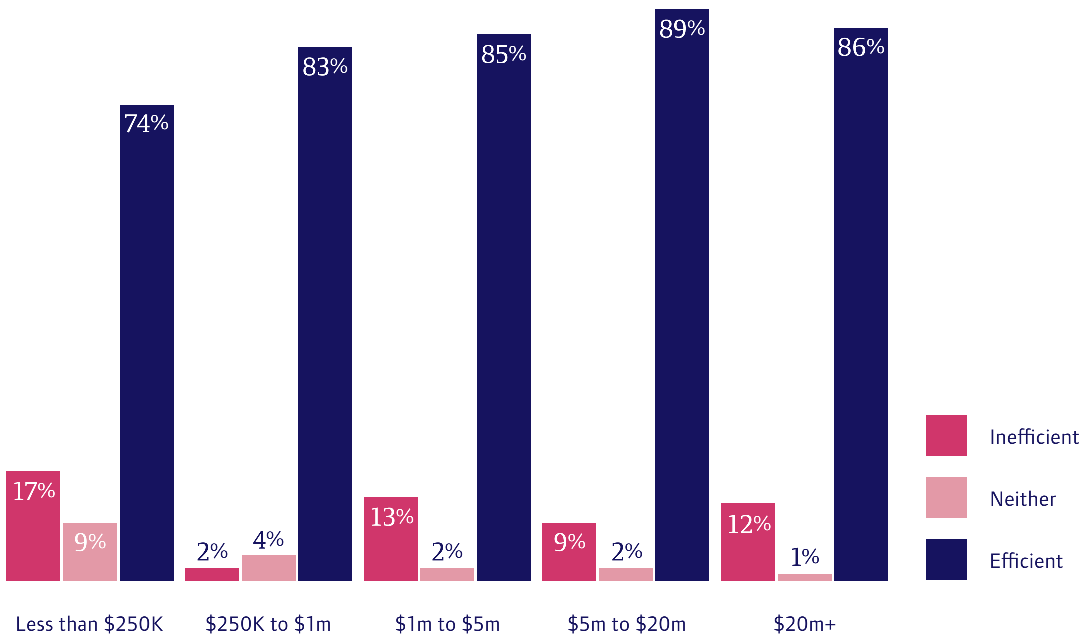
Directors' rating of efficiency by industry *(n = 2,357)*



4 ABS Cat. No. 5256.0 Australian National Accounts: Non-profit Institutions Satellite Account 2012/13. Appendix 1. These statistics have come from abs.com.au
Note: In order to separately identify culture and arts organisations, Category 1 was divided separated into two groups: culture and arts, and sports and other recreations and social clubs.

The majority of all directors rate their organisation as efficient but the rating of efficiency was slightly lower for the very small NFPs. Interestingly, the size of the organisation did not appear to make a marked difference to directors' views of its efficiency once the organisation had income over $1m. It is not clear if the lower ratings of efficiency of smaller organisations is unique to NFPs or if smaller for-profit organisations would also receive similar ratings. It may simply be an issue relating to the size of the organisation rather than its purpose.

Directors' rating of efficiency by NFP income *(n = 2,348)*



"Previously there was an assumption that government funding would see us through; that assumption is no longer viable."

Eight per cent of boards have discussed winding up

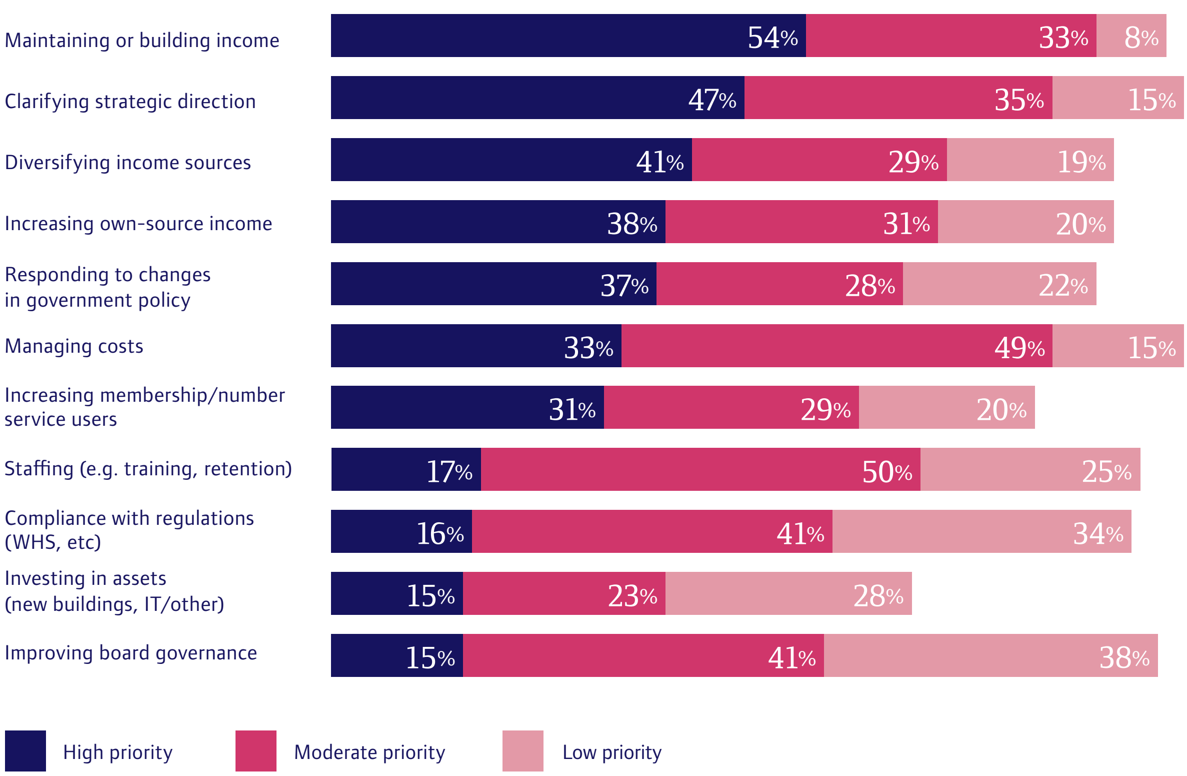
Eight per cent of NFP directors reported that their board had discussed closure of the NFP in the last year. There is no comparable information from previous years, or from the for-profit sector, so it is difficult to form a judgement of whether this is "appropriate" or not. This is the first year we have collected this information and we will track this measure in future studies.

As could be expected, discussion of winding up is correlated with NFP income. Twelve per cent of directors of NFPs with annual income below $250,000 had discussed winding up compared with 4% for those on the board of NFPs with annual income between $20m and $50m, and 1% for those on boards of NFPs with annual income over $50m.

Closing an NFP is an emotionally difficult choice and there can be a very strong sense of loss for staff, clients, volunteers, directors and the community. Some NFPs have been part of their communities for generations and have strong moral (if not financial) support. But closure may be the sensible option for NFPs which no longer have a relevant mission or are not financially viable.

Directors commented that boards will almost always seek to find a merger partner in preference to closure, but that in some cases the organisation may have diminished to an extent that the costs of a merger do not cover the benefits for the merger partner. In many cases, it may be a more sensible option for the NFP to be dissolved and the residual assets donated to an organisation with a similar mission or purpose.

NFP priorities for the next year *(n = 2,240)*



2.

Mergers are not just being discussed – they are happening

This year's study extended the examination of collaboration and merger activity in order to identify what is actually happening for NFP directors in our sample, and to provide more robust information for boards and NFPs thinking of a merger[5].

A third (32%) of directors reported that their board had discussed a merger in the last 12 months, 7% that they have completed a merger in the last year and 7% that they are currently undertaking a merger.

Despite their reputation, there is no evidence that NFP organisations are less responsive to market forces than other sectors.

In any conversation about the sector, it is common to hear people state that there are too many NFPs. Several of the directors in our groups expressed a belief that we have many charities providing the same services and competing for the same donations and that fewer, larger charities would be a more efficient use of funds. Coupled with this is the view that NFPs are less likely to collaborate, close or merge than for-profits. In other words, it is generally believed that not only are NFPs inefficient, but the NFP sector as a whole does not respond well to market forces.

Again, the Productivity Commission's 2010 report stated this explicitly when it said, "NFPs appear to be reluctant to close, merge or collaborate" and referred to vested interests, lack of strategy and deficient infrastructure to support aggregation as the key causes. It also reported that NFPs are reluctant to grow, especially through a merger, as it will reduce their connection to their community. This may turn out to be true but to date, this and similar sector commentary has not been supported by evidence.

Our coverage of merger activity was expanded this year to include additional analysis of the why and how of mergers. We held two focus groups with directors with current experience of mergers and included additional questions in the survey.

5 NFPs could have both merged in the last 12 months and have been likely to merge with another NFP in the next 12 months.

Merger activity

(n = 2,259)

32% Discussed merger

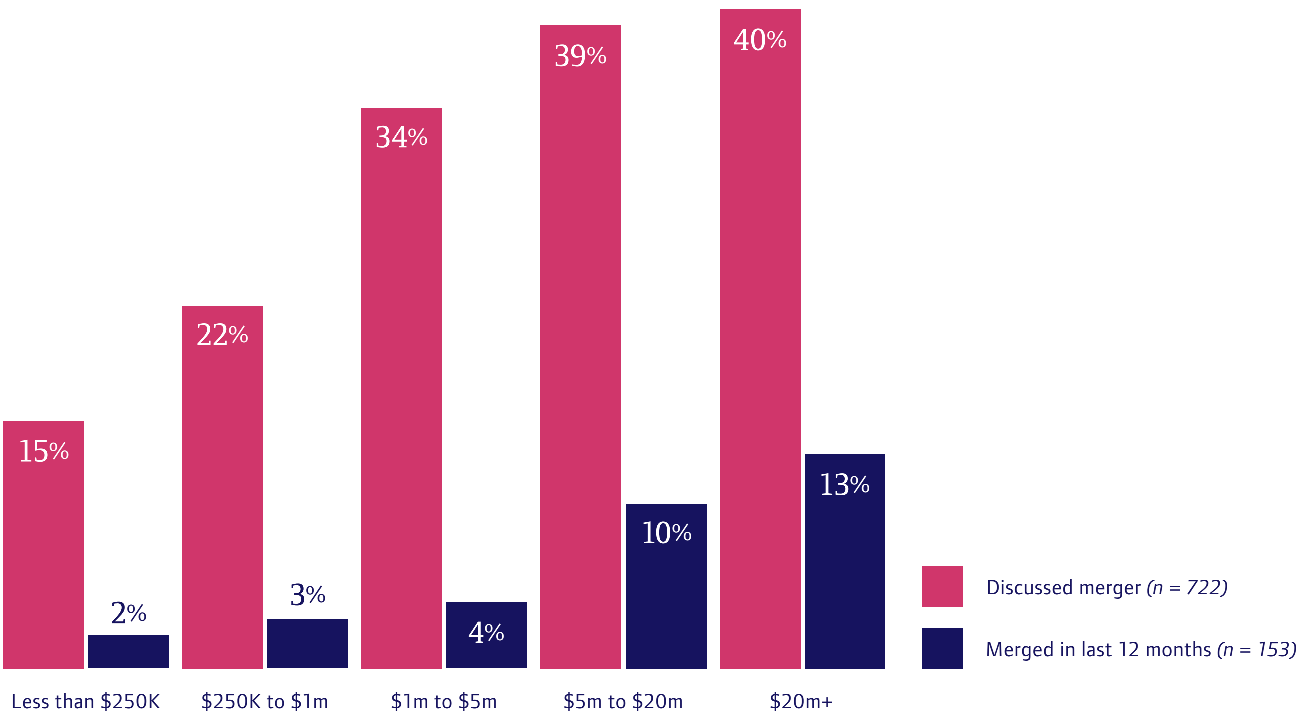
7% Currently undertaking a merger

7% Completed a merger in the last 12 months

It's the larger, not smaller, NFPs that are merging

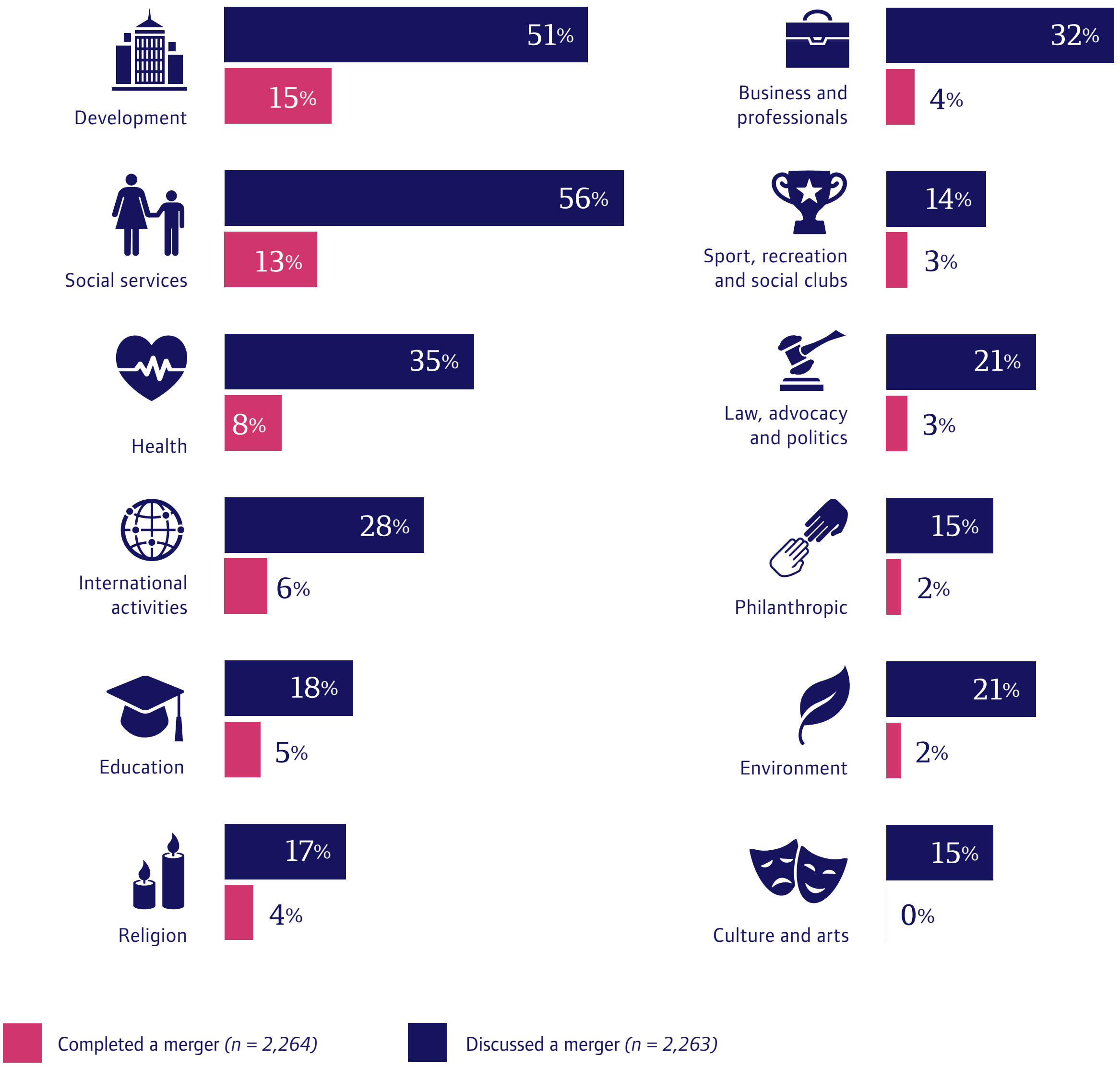
The proportion of NFPs discussing or undertaking mergers is related to the size of the organisation and its industry. Only 15% of directors of NFPs with an annual income of less than $250,000 and 22% of those with annual income between $250,000 and $1m had discussed a merger, compared with 40% of directors of NFPs with annual income over $20m. Rates of actual mergers in the last 12 months reflect this with only 2% of directors of the smallest NFPs reportedly having actually merged, compared with 13% of directors of NFPs with income over $20m. As such, it appears that smaller NFPs have lower rates of merger discussions than actual mergers, despite having lower efficiency and higher rates of consideration of closure.

NFP merger discussions and mergers in the last 12 months by income



The incidence of merger discussion and activity also varies significantly across industries. More than half of directors of NFPs in social services or development report they are discussing mergers, compared with only 14% of those in sport and recreation and philanthropy. These results were reflected in the numbers of merger completions, with the rates in development and social services twice as high as the NFP sector average. It is not clear why the incidence of mergers varies so widely; it could be the result of change in NFPs' policy or operating environments, including shifts in demand, technology, encouragement by funders (including governments) or increasing competition.

Merger discussion and completions by industry sector



Directors warn that a merger is not a panacea

Directors who had considered or were undertaking a merger in the last year report that the main reasons for their merger was to better meet their mission (24%), improve efficiency (20%) and broaden the range of services provided (19%).

However, they made it very clear that a merger is only one of a number of strategies boards should be examining as a means to pursue their NFP's mission. Mergers are complex, costly and time consuming and not guaranteed to succeed, and directors are concerned that the increased discussion of mergers is making them "trendy" or creating the impression they are a "panacea".

Directors with personal experience of mergers advised their colleagues to carefully consider all alternatives, such as organic growth, collaboration and joint ventures, franchising and other strategies, and not be pressured into a merger by fashion or funders. The latter appears to be a valid concern given that our survey found that 14% of directors report that they are merging or considering a merger in order to be more attractive to funders, and 9% indicated that government encouragement was the main factor.

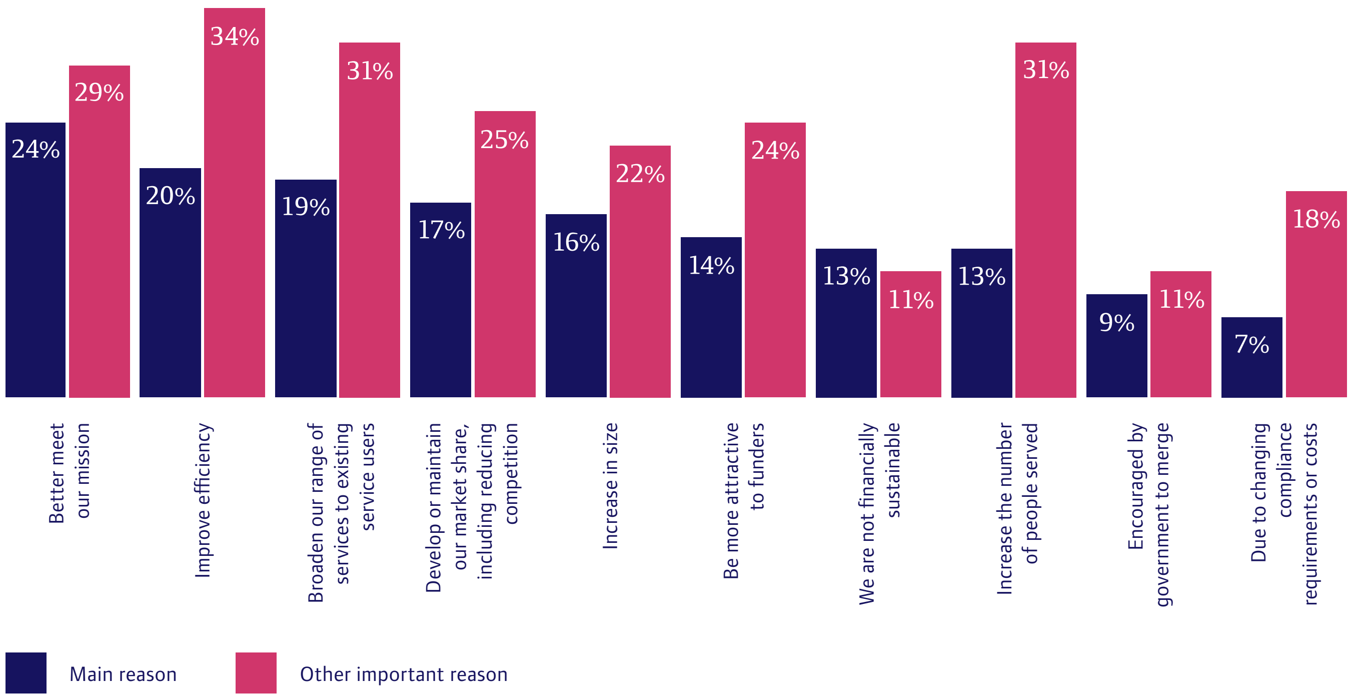
Directors also advised that, for those organisations that are struggling to survive, closure (and the transfer of assets/services to another NFP) rather than a merger may be a more financially responsible option than running down the organisations' assets, goodwill or client base in an attempt to survive or in the hope of finding a merger partner.

Efficiency hopes may not be realised

A quarter of all directors of organisations currently undertaking a merger stated that one of their main reasons to merge is to improve efficiency, whereas only 15% of those that had completed a merger gave efficiency as a goal.

While the reasons for a merger may be different for those that have completed a merger in the last year and those currently considering a merger, this finding reflects the experience of directors in our focus groups who reported that efficiency is often a key justification for a merger, but the gains are often less than predicted.

Reasons to merge *(n = 723)*



NFPs are collaborating

Seventy per cent of directors said their organisations are collaborating with others to advocate for their sector or beneficiaries, 43% subcontract the provision of services to other NFPs and 39% have agreements (e.g. memoranda of understanding) with another NFP to refer or service clients. In addition, over a quarter share resources with another NFP and 15% share back-office functions such as payroll, accounting and administration. Noting that 45% of all our respondents are referring to NFPs with annual income over $1m, this would suggest that there is considerable collaboration activity among at least the larger NFPs. Whether or not this is “sufficient” collaboration is difficult to determine without equivalent historical information or data on for-profits. It is also possible that the community has different expectations regarding the correct level of collaboration in the NFP and for-profit sectors.

The highest levels of collaboration are among organisations in social services, with 78% of directors reporting that their NFP collaborates with others to advocate for their sector and beneficiaries. Also, 56% reported having MOUs[6] with other NFPs to refer or service clients. Religious congregations are most likely to share back-office functions and administrative resources with other organisations.

The level of collaboration also varies by turnover. Not surprisingly, NFPs with an annual income below $250,000 reported higher levels of collaboration with back-office functions and resource sharing, but lower levels of collaboration for advocacy and through MOUs for referral or service delivery, which is highest with the larger NFPs.

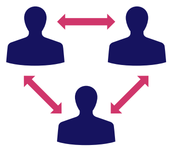
Extent of collaboration with other NFPs *(n = 2,147)*

70%

We collaborate to advocate for the sector or beneficiaries

43%

We subcontract the provision of some services/products



39%

We have an agreement (or MOU) to refer or service clients

26%

We share resources

15%

We share back-office functions

9%

We outsource back-office functions to another NFP for which we pay a fee

6 Memoranda of Understanding

Director tips on mergers

The secret to a successful merger is in recognising that it is not about ticking off a list of tasks, but in understanding the purpose for these tasks and how they apply in NFP settings.

The following is a compilation of advice from directors responding to the survey who have recent experience with NFP mergers. It goes beyond the usual checklist and addresses some of the underlying issues that impact most mergers.

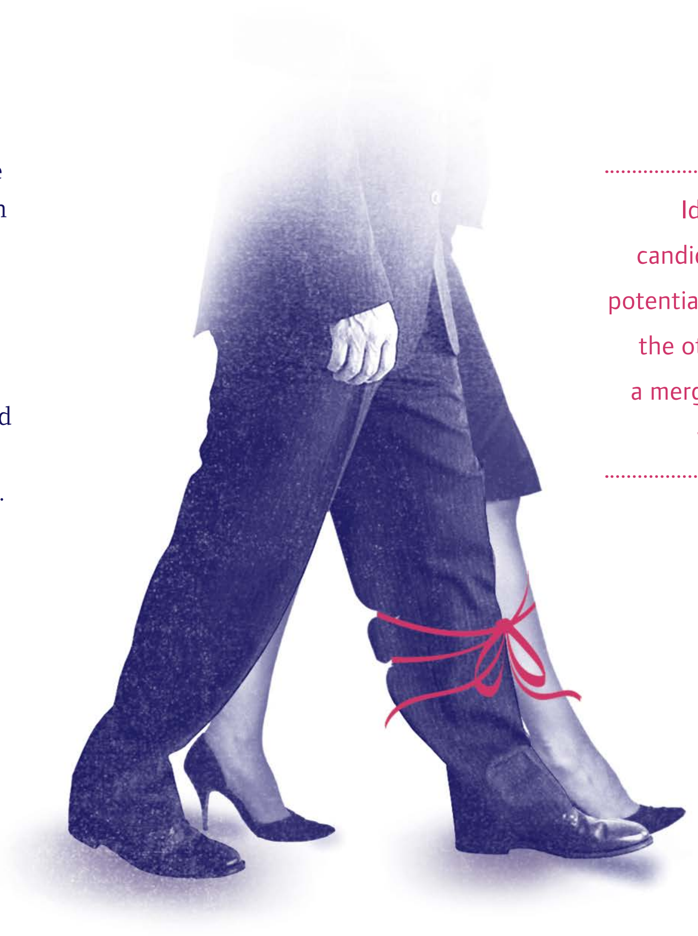
1. Always recognise that the NFP exists to serve its beneficiaries and your role and that of the board is to act on their behalf.
2. Ensure you have a very good understanding of the profile of your beneficiaries and their needs before you start. A merger is not the time to find out that the board doesn't fully understand its service users and broader stakeholders.
3. Recognise that an NFP merger is a multiparty negotiation, but unlike mergers with for-profits, the beneficiaries are not at the table. To keep priorities clear and egos in check, constantly remind yourself and others that the NFP exists to get the best result for beneficiaries, not for itself, its staff or the board.
4. Check that a merger is the best strategy to achieve your mission. Ensure that other options have also been fully explored.
5. Develop a clear vision of the end state for the NFP post-merger. This should focus on how the new entity will deliver better or more services.

Develop a clear vision of the end state for the NFP post-merger. This should focus on how the new entity will deliver better or more services.

"The efficiencies you think you gain, you often don't. People often do the numbers and see that they make big savings by having half the number of CEOs and senior executives. But unless those people were doing nothing, that work has to go somewhere."

6. Take stock of your negotiating assets. What have you got to "sell" and how skilled are you at negotiating? Determine what is your ideal outcome and what are the deal breakers.
7. Identify several merger candidates and assess their potential. Seek to understand the other NFP's purpose in a merger and their best and worst case outcomes.
8. When undertaking the cost-benefit analysis, accept that even quantitative assessments and models are based on judgements of expected future costs and gains. Do some savage sensitivity analysis and don't proceed if the gains are not compelling.
9. Conduct due diligence to confirm the costs, benefits and risks, but also to assess cultural alignment. Directors attribute most failures of mergers to poor cultural fit, but failure to align is not just the results of differences but from an unwillingness to change.
10. Early in the process, define who will fill each role in the post-merger board and leadership team. Despite telling the staff and board that it is not about them, uncertainty leads to dysfunction.
11. Change hurts and people often get angry and resistant. Develop your integration and change management timetable and keep it as short as possible as the benefits will only be fully realised when the merger is complete.
12. Sell the benefits constantly to all stakeholders. The greater the genuine improvement for beneficiaries, the easier this will be.
13. Accept that a merger will involve emotional labour. Even "takeovers" can come with feelings of guilt, regret, loss and sadness. Unlike for-profits, NFPs are rarely established with an exit strategy in mind and "selling out" the tangible and intangible assets built through the hard work of volunteers and donations can feel like betrayal.

"A merger is harder than expected. Open, continuous communication with the other organisation is key."



Identify several merger candidates and assess their potential. Seek to understand the other NFP's purpose in a merger and their best and worst case outcomes.

3.

NFP directors want a more collaborative relationship with government

On average, directors gave the Commonwealth Government a score of 4.6 out of 10 for understanding NFPs, nearly half (48%) awarded it a score of less than five. Directors felt that there is a big gap between government's understanding of NFPs and the reality, and also a lack of awareness of the different issues facing each part of the sector.

The reasons given for the low scores included the recent drawn-out consideration of the future of the Australian Charities and Not-for-profits Commission, the reduction and reformation of funding to the sector and particularly reforms in procurement, which were seen as poorly managed. As a major purchaser (often the only purchaser) of services from some NFPs, the Commonwealth and other governments considerable power to influence the sustainability and growth of NFPs.

There is no doubt that the NFP sector has experienced significant change over the last decade, driven largely by changes to government policy. The directors in our focus groups study suggest that a more mature and constructive relationship is required between the sector and the Commonwealth Government.

Directors understand the desire from government for an efficient NFP sector and significant gains in efficiency have been seen in recent times. However, these gains are not reflected in government processes or policies, which are constraining the sector from delivering more innovation.

Rating of the Commonwealth Government's understanding of the NFP sector

48%	14%	38%
4 or less out of 10	5 out of 10	6 or more out of 10

Directors want government to improve procurement practices

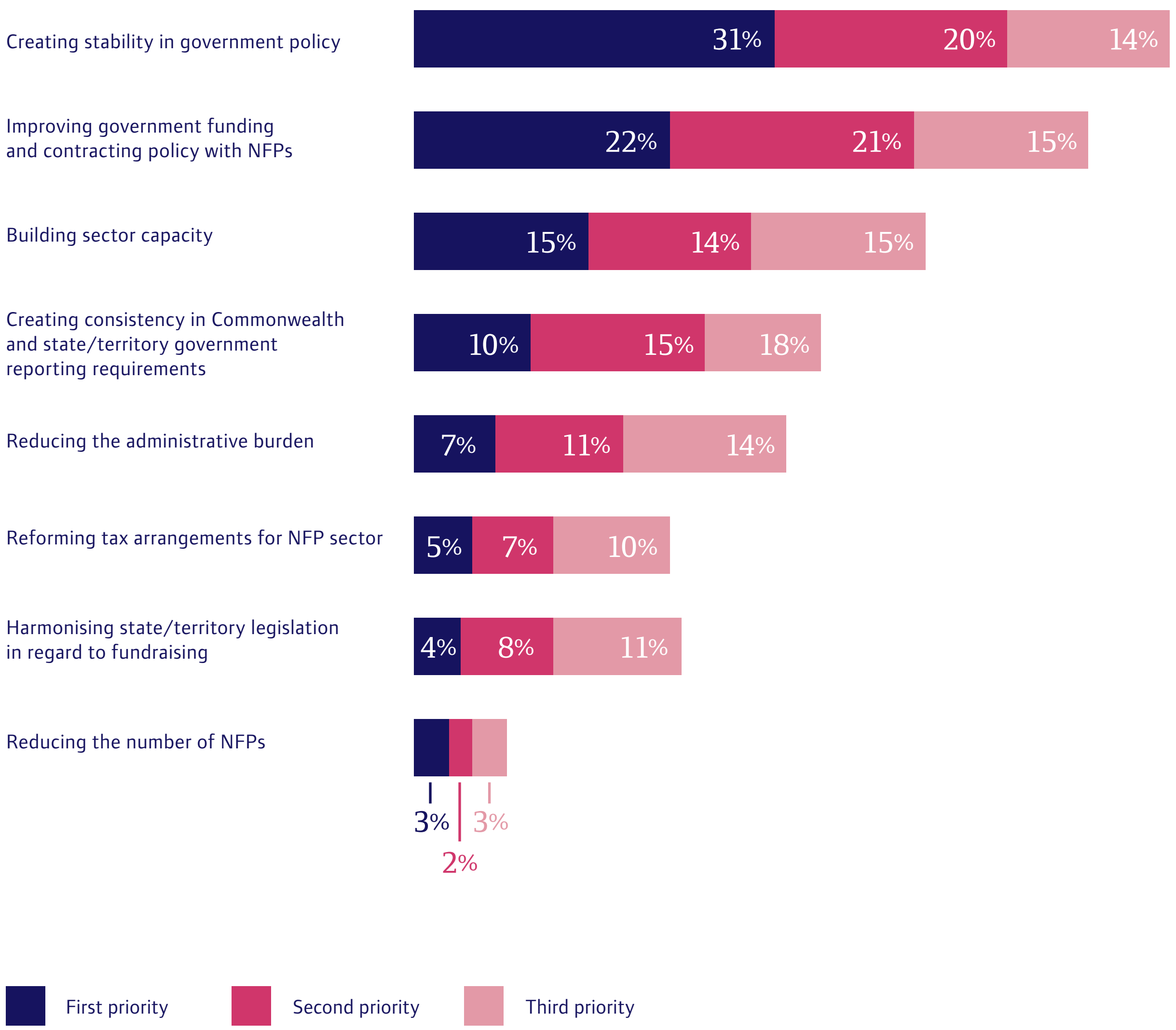
Our respondents again called for stability in government policy, but this year one in five also drew attention to the need to improve the way the Commonwealth contracts with the NFP sector.

In particular, they want longer (five year) contracts, more consultation in program design, more useful performance measures and simplified reporting. They also want the government to help build sector capacity and to reduce the administrative burden. Less than 7% of directors believe that reducing the number of NFPs is a priority.

Despite increased certainty about the future of the ACNC, directors are urging the government to support the ACNC in its aims of reducing red tape and harmonising legislation.

Priorities for the Commonwealth Government

(n = 2,160)



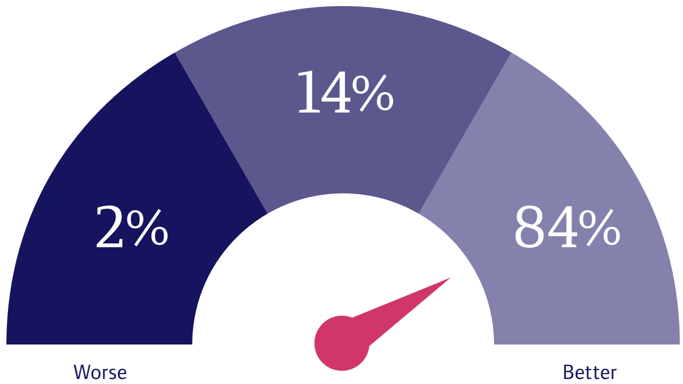
4.

NFP governance continues to evolve and mature

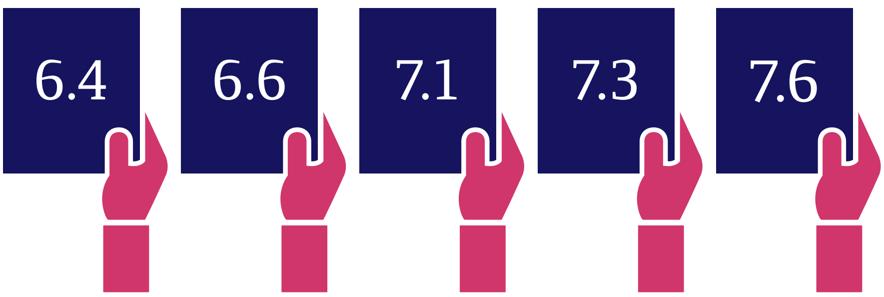
Directors' average rating of their organisations' governance has remained unchanged for three years and remains at 7.05 out of 10.

Continuing the trend from previous studies, the quality of NFP governance continues to improve. Eighty-four per cent of directors believe that the governance of their organisation is better now than it was three years ago.

Directors' opinion of quality of their boards' governance compared to three years ago *(n = 2,373)*



Directors' rating of governance by NFP income



Less than $250K *(n = 322)* | $250K to $1m *(n = 387)* | $1m to $5m *(n = 624)* | $5m to $20m *(n = 563)* | $20m+ *(n = 485)*

Overall rating of governance effectiveness varies with organisation size

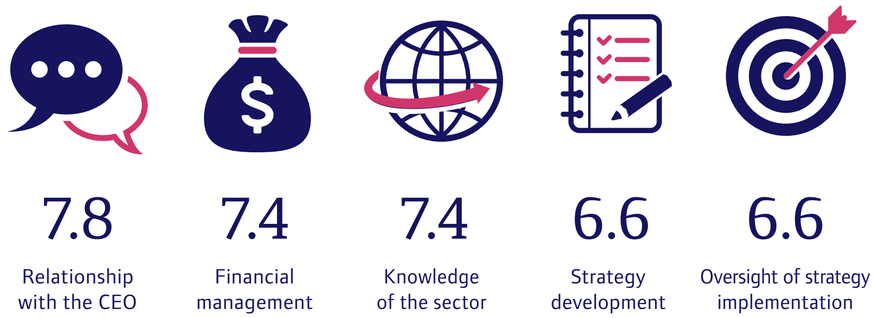
There is a correlation between the income of the NFP and directors' rating of governance effectiveness, with directors of larger NFPs giving higher average scores. There is little variation of ratings across industry sectors.

Despite improvement, directors continue to seek ways to further enhance governance

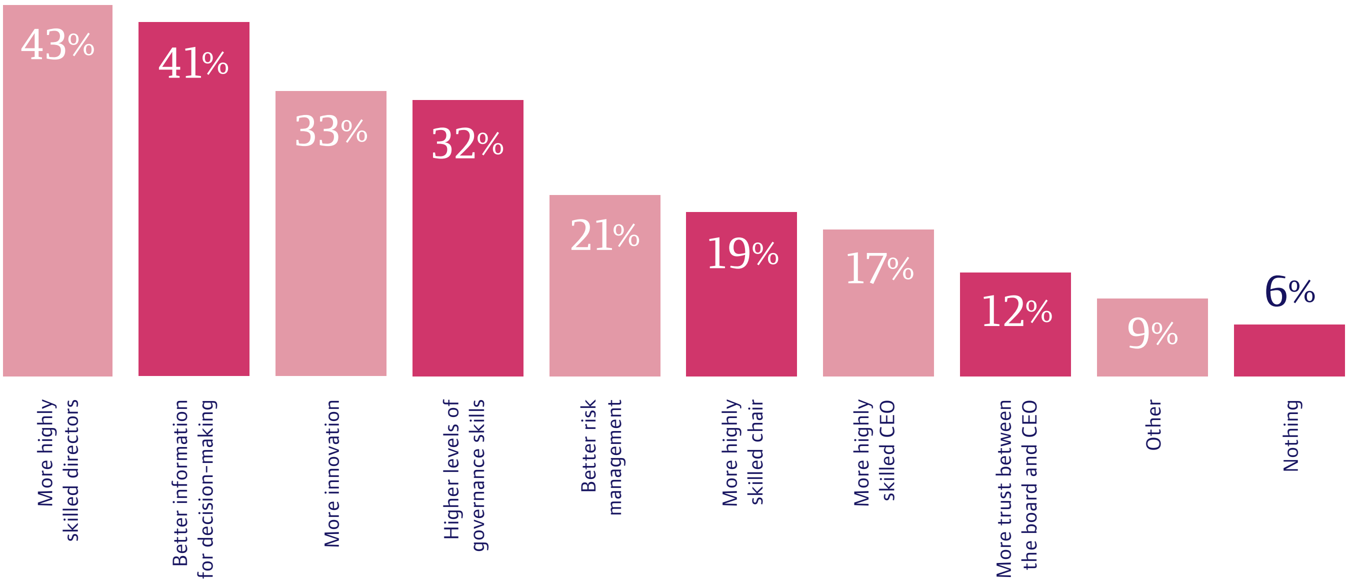
One such area is the board's collective skill set. On average, they gave their board 7.8 out of 10 for its relationship with the CEO and 7.4 for both financial management and knowledge of the sector. But they were not so impressed with the quality of their board's risk management and its general governance experience, which both scored 6.5.

Directors' rating of their boards' skills

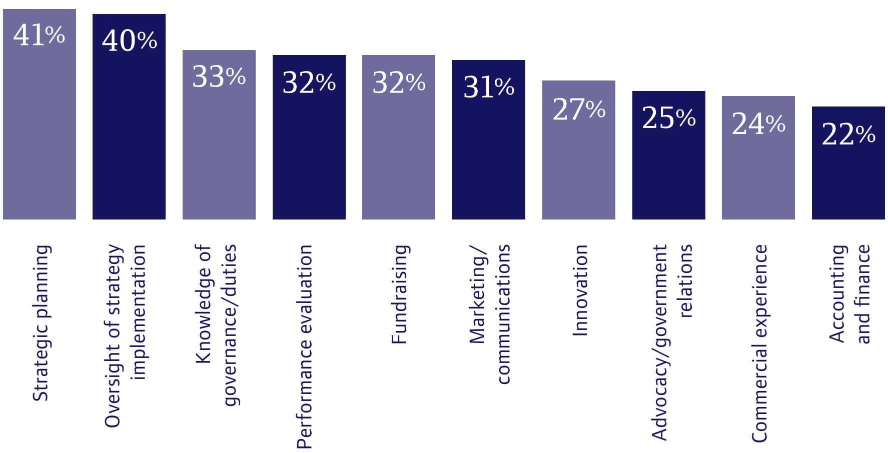
(n = 2,183)



Factors that would most improve my board's performance *(n = 2,375)*



Areas in which my board needs more skills *(n = 1,373)*



Directors continue to see a need for board members with higher levels of skills (43%) and better information (41%). A third believe that a higher level of specific governance skills would also improve their board's performance. Of the directors who believe their boards need better skills, 41% reported needing improved skills in strategic planning, 40% in the oversight of strategy implementation and a third suggested their board needs training in governance/directors' duties.

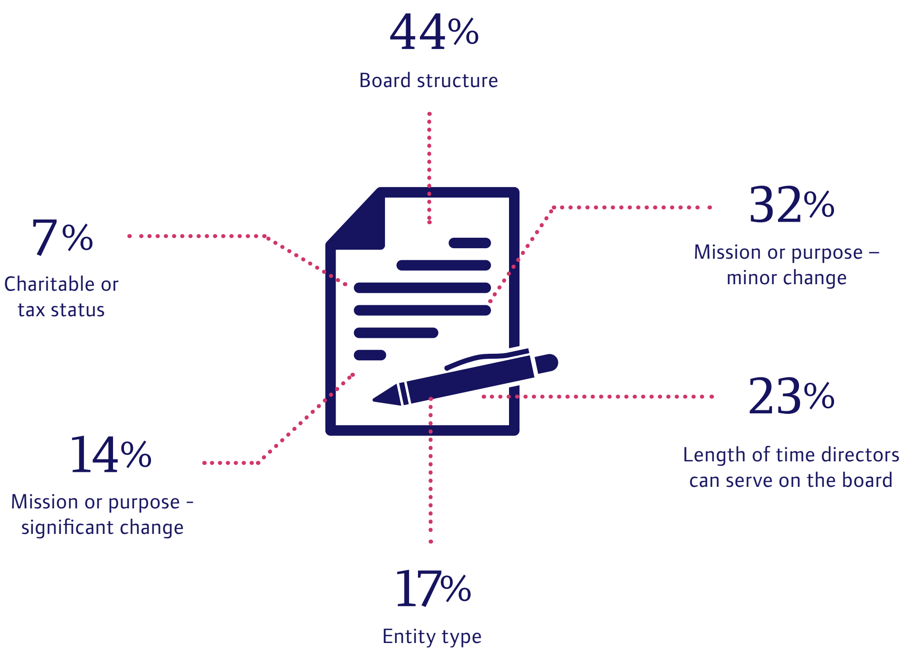
Board structures

Changes to board structures and governing documents will be absorbing a significant amount of directors' time for a third of directors (44%) over the coming 12 months.

This reflects the evolving nature of the NFP sector and their operating environment and a recognition that governance structures need to be regularly reviewed and updated.

Changes to governance structures in the next year

(n = 795)



Performance measurement is a major and on-going challenge

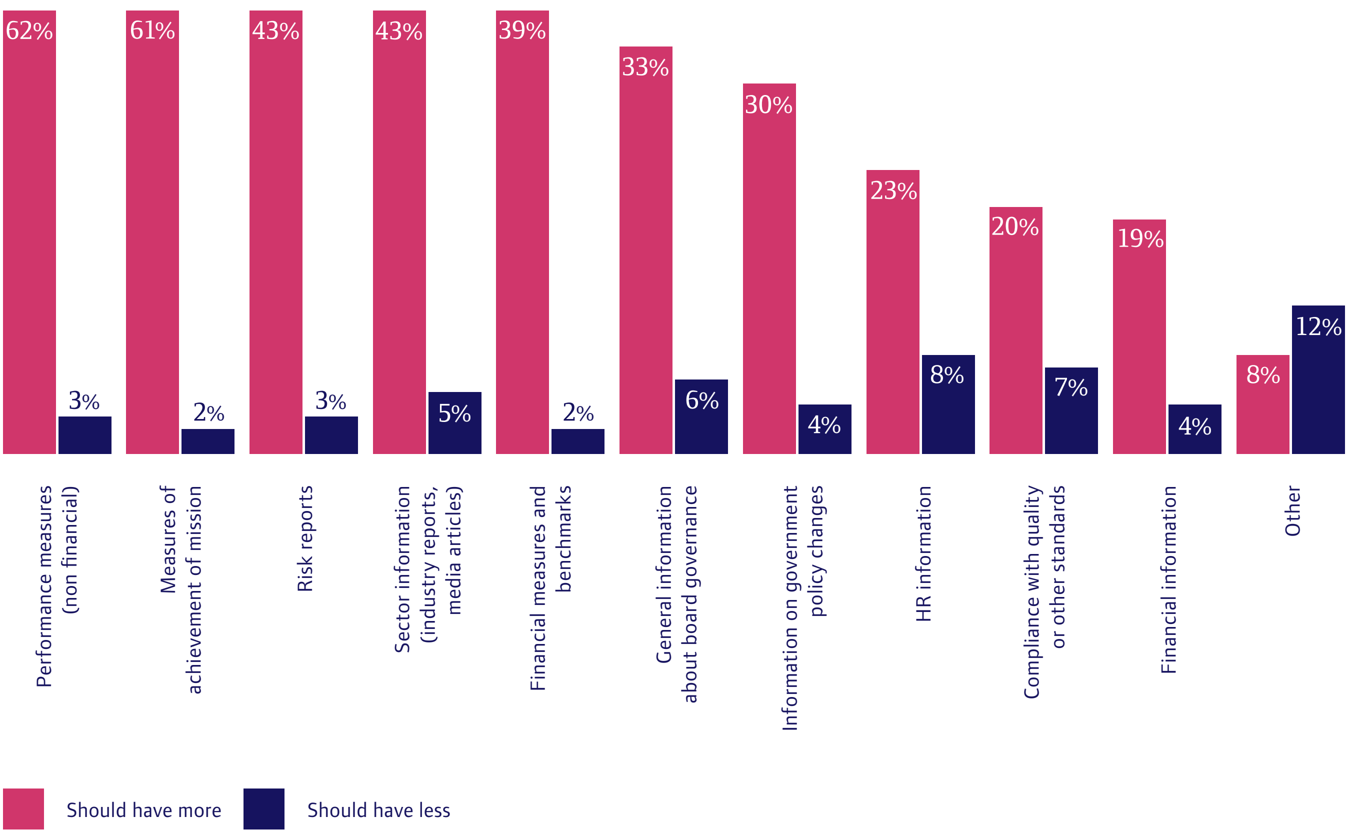
Confirming a key finding from the 2014 NFP Governance and Performance Study, less than half of all directors believe that their board is effective or very effective in measuring their organisation's performance against mission.

Directors see accurate, timely and useful information as a key strategic asset and they consistently commented on the need for boards to improve in this area. They also spoke of CEOs and boards that complain of low levels of director engagement in innovation and strategic planning, yet are not providing directors with the information they need to be more active in these areas.

Directors in our focus groups spent some time discussing the challenges of developing and using performance measurement systems that can meet internal and external reporting requirements. They also commented on the cost of reporting and requested data, or at least estimates of the costs of reporting, so they can evaluate the return on investment.

For those operating under contracts with governments, there is an increasing requirement for outcomes measurement. Directors believe that the pace of improvement in outcome measurement will be determined by the rate of improvement in the quality and timeliness of data, and they believe that there is little point in pursuing outcomes measurement where there is no reliable longitudinal data to measure them.

Boards' information needs *(n = 2,150)*



5.

NFP boards are leading diversity

Conversations about board diversity generate hot debate. This year, we deepened the discussion to separate rhetoric from practice and extended it to discuss age and cultural diversity.

Our findings show that NFP directors are leading the conversation on the role and benefit of diversity in the boardroom. Thoughtful engagement with the challenge of representation and a continuing focus on gender and cultural diversity emerged as key themes.

"We are over-represented in board members with Anglo-Saxon backgrounds. We have no other racial or cultural background on our board."

Key findings	
Overall, NFP boards have better gender diversity	38% of NFP directors responding to our survey are women, and 60% of these are confident their board composition broadly reflects the gender balance of stakeholders.
But there is still work to do…	Over a third of NFP directors believe that their boards are under-representative of women – and our findings on director fees show significant disparity between fees earned by men and women.
More cultural diversity is needed…	Over half of respondents feel that their board is under or over-represented in particular cultural groups, with more than 70% of these noting a dominance of "white, Anglo-Saxon" directors.
Directors are looking for the 'next generation' of board members for NFPs…	While the importance of balancing age diversity with experience and skills was noted, over half felt that their own boards were under-representative of directors aged 30 to 40 years. The average age of respondents to this survey was 56 years with less than 5% aged below 40.
Diversity is seen as a continuing challenge…	NFP boards are engaged and considered in their review of diversity issues and consideration of board composition.

Diversity compared to what?

In group discussions it was clear that directors' views on diversity reflect their personal values, judgements regarding societal values (i.e. what we should be working toward as a society), and the practical (i.e. what will work for our board). In many cases they found these aspects difficult to align.

Importantly, there are also differences of opinion on a key question – "compared to what?" It is generally agreed that the skills of the board need to be diverse and should reflect the needs of the organisation at that point in time. However, when it comes to board demography, directors' views of whether their board has a suitable cross-section of directors depends on whether they compare their board with other boards, to the potential pool of directors, to a benchmark or quota, to the Australian population, or to specific populations, such as stakeholders.

> "We need more representation of Indigenous communities and other cultural groups."

> "I can't see any benefit in reflecting stakeholders in board composition, especially when you consider who our stakeholders are, where they are located and their skill sets."

Not all directors believe boards should be more diverse

Diversity as a reflection of key stakeholders

This year, our survey asked directors to compare their board's composition with the last of these, the demography of their stakeholders, including service users, staff and funders. Specifically, they were asked to state whether their board profile is generally reflective of their NFP's stakeholders, or under- or over-represented in the areas of gender, age and cultural background. This is not an easy question. For example, a single-sex school or club may have all female students or members, mostly female staff, but parents and volunteers of both genders.

Cultural backgrounds and age can also be similarly mixed across stakeholders, so considering the demography of the board in regard to its stakeholders is not an easy task. There are also boards that are dominated by a single gender, cultural background or narrow age range, which is totally appropriate given the organisation's focus. Examples include men's sheds, health services for women, Indigenous organisations and faith-based NFPs.

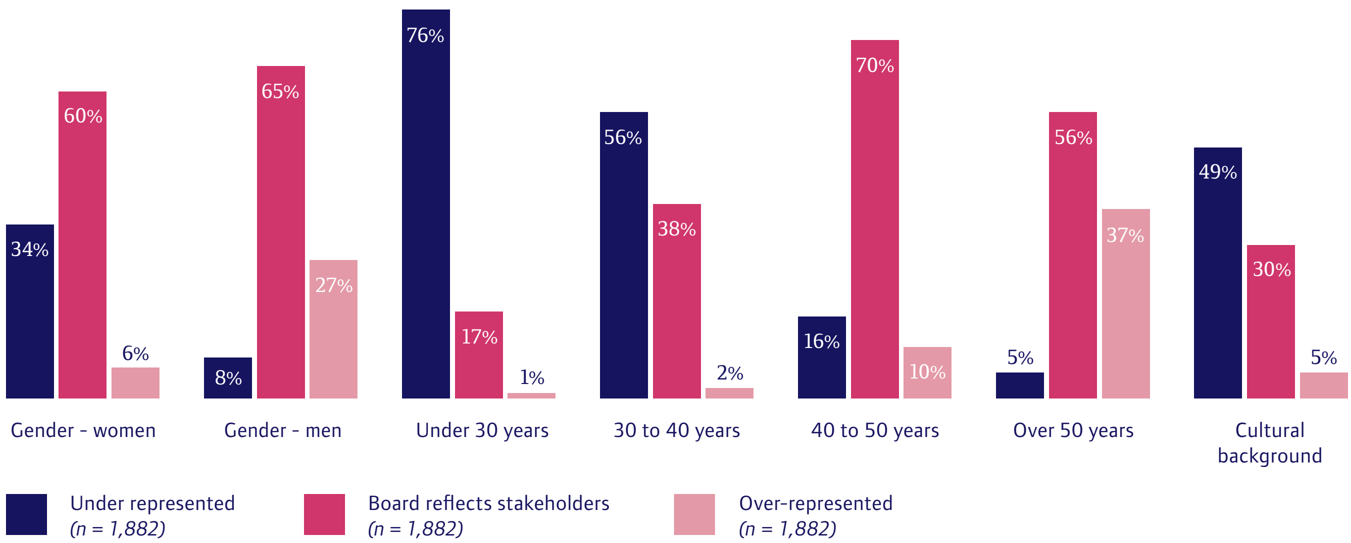
Directors in our groups made it clear that they were not expecting boards to be perfectly reflective of the demography of stakeholders, but rather that boards should be concerned where or when the profile is drawn from a narrow segment of the community.

Gender

The ratio of female to male directors in NFPs is generally higher than in for-profits. Of the nearly 1,900 NFP directors, 38% are women and 62% men. Of this group 60% believe the number of women and 65% that the number of men is reflective of their stakeholder demography.

However, despite successful initiatives to improve the ratio of female directors, over a third consider their board to still be under-representative in regard to women. Yet, the gender issue is not entirely one sided. Eight per cent of directors believed their board is under-representative of men.

Board composition



"This board governs an organisation that provides support to those involved or at risk of becoming involved in the criminal justice system. The composition of the board is driven by skills rather than stakeholder representation. We are advised by a consumer advisory group, which includes those with first-hand experience of the system."

Cultural background

Reflecting the comments in the focus groups, 834 directors (more than half) believe that even when broadly compared with their stakeholders, their board was under- or over-representative of people from one or more cultural background. Remembering that each director was asked to compare their board's profile with their organisation's stakeholders, detailed analysis of the data showed that 70% of these directors reported that their board is over-representative of Anglo-Saxons, with many commenting there were only Anglo-Saxons on the board.

Thirty-six percent reported that their board was under-representative of (or had no) Indigenous people and 12% that they had few or no people from Asian backgrounds. Others specifically mentioned that their boards did not include people with direct or indirect experience of their organisation's beneficiary groups, such as those with disabilities or ill health, or from certain nationalities.

Age

The average age of directors in this year's study is 56 years, and less than 5% were under the age of 40. Of these directors, three-quarters stated that their board was under-represented in regard to people under 30 years, and more than half said it was under-representative of those between 30 and 40 years. Correspondingly, over a third of directors said their board was over-representative of those over 50 years.

However, directors said judgements about the right level of representation are more difficult when it comes to age. Boards need people with significant professional and business skills that can only be gained after many years of work and life experience. They also commented, that, unlike gender and cultural background, older board members did have experience of being young. Nonetheless, the need to broaden the age range of directors was a pressing issue for many as they saw a need to develop the next generation of board members and to ensure that their board was in tune with the requirements of its members or service recipients.

Challenges and alternatives

Directors reported that building a board with a diverse profile is a constant challenge. For boards with six to eight members, the addition or loss of one or two members can quickly shift the profile from diverse and reflective of stakeholders to homogeneous. Similarly, it can be difficult to find the right skills, let alone the perfect combination of skills in individuals from particular cultural backgrounds, age groups and gender.

Directors said they would choose the best person for the role, rather than turn down a good candidate because of his or her personal characteristics. For those on representative boards, including boards of federated organisations, directors have little to no influence on who is appointed to the board. Directors mentioned that one of the ways they address this is to establish advisory groups, client liaison groups or other committees to ensure they have access to the views of members and beneficiaries. Several with a younger client base or staff profile mentioned that they had established youth advisory boards or junior boards.

6.

Directors' contribution: donating money *and* time?

Thirteen per cent of directors are paid

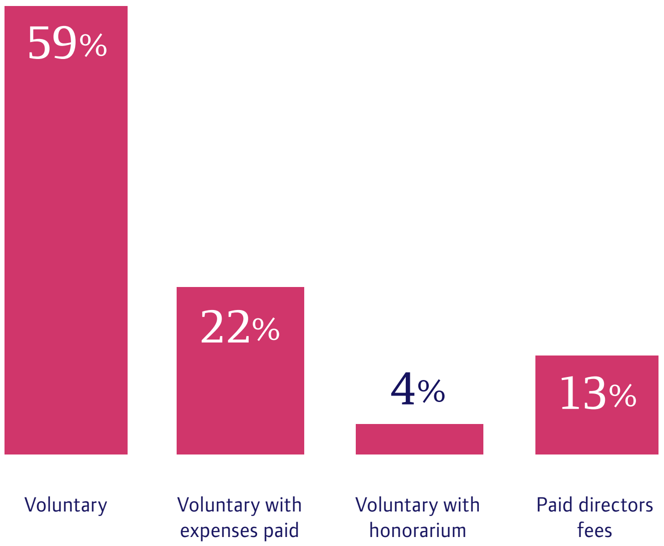
As in previous years, our study found that 87% of directors are volunteers (or paid an honorarium only) and that there is a correlation of payment of directors with the turnover of the NFP.

Thirteen per cent of directors are paid and 4% report receiving an honorarium. The average amount paid was $25,700 and the median amount $17,000. The highest paid director reported receiving $200,000 and 14% of directors received $50,000 or more.

Director pay varies within boards depending on the duties of the board members, such as working on additional sub-committees. Just less than half of directors reported that all directors receive the same amount (the chair was excluded) and 11% reported that they are paid different amounts. In some cases, only the board chair is paid.

There is a variation of the number of directors being paid depending on the income of the NFP and the sector. Thirty-four per cent of directors of very large NFPs are paid, whereas only 2% of directors of organisation with income less than $250,000 are paid. Payment of directors is also higher for those in health, development and the environment industries.

Directors' contribution: donating money and time? *(n = 2,592)*



Many directors are both volunteering and donating money

This year we asked the volunteer directors if they also made donations to the organisations for which they were directors. In addition to giving their time, 39% of directors made donations and 19% made a donation of $1,000 or more to the organisation. The median amount donated was $1,000 and the largest reported donation was $110,000. In total, in addition to their time, 889 directors donated $2.1m in 2014-15 financial year. There is some correlation between rates of donation and organisation income, with higher rates of donation to organisations with lower income.

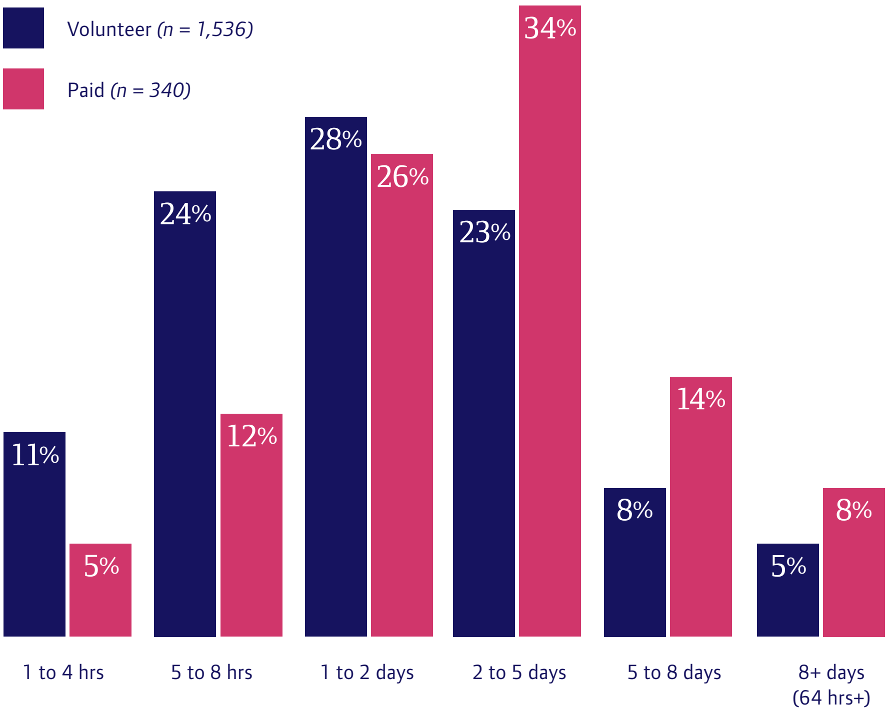
The number of hours contributed remains high

Directors' contributions to NFP governance continues to be significant. On average, directors responding to the survey have 1.6 directorships and spend 24 hours per month working in directorship roles.

Directors who are paid spend more time on the job

The number of hours directors work for a single board is higher for paid directors. Over half (56%) of directors[7] who are paid report spending more than two days per month on governance work, compared with 36% of those who are not paid. These results do not necessarily mean all paid directors work longer hours. For example, they may reflect the fact that in some cases only the board chair is paid, reflecting the greater amount of work required in this role.

Comparison of time spent per month on a single board



There are differences between the director fees paid for male and female directors

When analysed by gender, the data shows differences between the ratio of men and women who are paid and the average amounts paid. Thirteen per cent of male directors are paid compared with 10.8% of female directors, and male directors receive an average of $26,800 and female directors $22,000. This difference is higher for the top-ten paid directors, with the top-ten men being paid an average of $123,000 and the top-ten women $69,550. This differentiation is difficult to explain and is not accounted for by differences in the size or sector of NFPs, so further research is required. It is unlikely that men and women on the same board are paid differently, so the results may suggest an aggregation effect or that more men sit on additional sub-committees or are board chairs. This is the second year the research has shown a difference in average pay of male and female directors.

7 Note: These are non-executive directors.

7.

Culture and the arts – balancing on a tightrope

NFPs in the culture and the arts sub-sector comprise a broad range of organisations from neighbourhood art galleries and ensembles, to some of the largest cultural organisations in Australia. Despite the size and contribution of this sector, there is very little accurate information relating to these NFPs, their activities or their funding.

This year our study included in-depth research into culture and arts NFPs. We conducted two focus groups with directors in this sector and included additional questions to the survey.

There is also very little up-to-date information on the source of income for NFPs in this sector. For most, the majority of their income is from customers, but corporate and private donations and Commonwealth, state and local governments are also significant contributors and, for some, their dominant source of income[8].

It's all about income

Building and diversifying income is a key priority for all NFP directors, but even more so with directors of culture and arts organisations. For this group, it was by far the toughest issue they face.

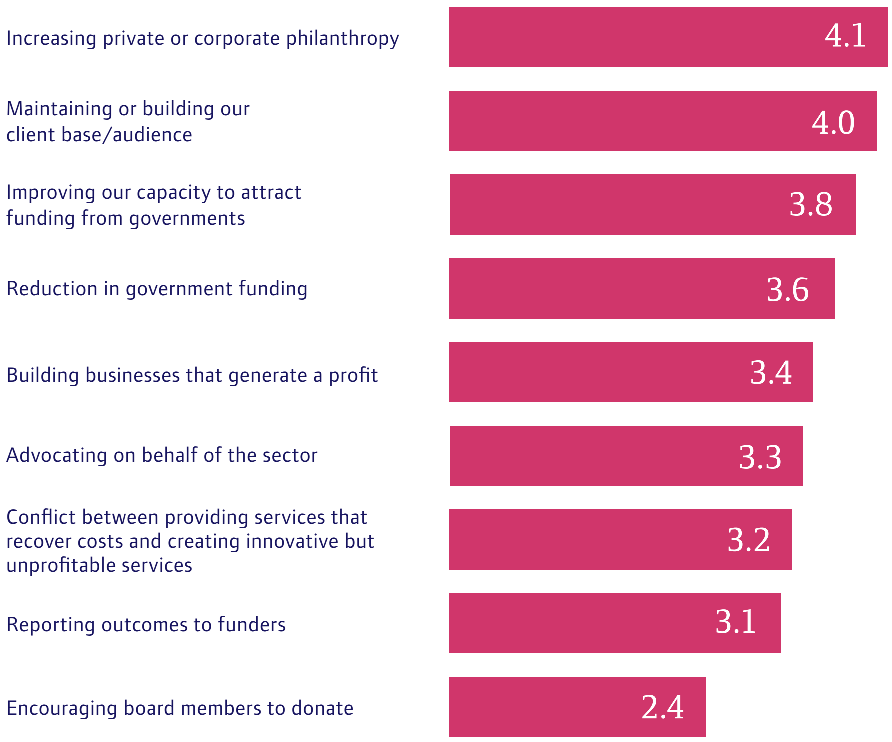
Directors in the sector were asked to rate the most important issues affecting their organisation, and four out of the five top issues nominated were income related. For several, the economic slowdown and a reduction in public sector funding had prompted significant changes and innovative approaches to income generation.

Sixty-three percent of directors from this group that said their board needed more skills nominated "fund raising" as the most important skill for directors, with strategic planning second at 40%. Although many are seeking alternative funding sources, directors noted that funding providers or sources of income each have unique requirements and changing funding sources creates new obligations for organisations.

In some cases, the challenges for funding and governance varied depending on how the entity came into being. Unlike most other NFPs, some arts organisations arose from "one off" events run by a few volunteers to become large-scale annual productions and they faced challenges that come with rapid growth, particularly in governance and funding.

Most important issues for the next three years rated out of five

(n = 133)



"We are in a highly uncertain funding environment with little support for arts funding across the government and private sectors."

Relationship with government

A factor that was unique to this sector is a relatively low level of collaborative advocacy. Directors commented on the impact of the Commonwealth Government's reallocation of 15% of the Australia Council for the Arts funding to the new National Programme for Excellence in the Arts.

While this was almost universally seen as a poor decision, directors reported that their organisations would not be voicing complaints about it for fear of retribution by governments. They gave examples of situations in which funded organisations had funding "redirected" to other arts bodies after making complaints about government policy decisions. The data for all NFPs shows 70% collaborate with others to support their sector or beneficiaries. For directors in culture and arts sector, this fell to half of that figure, or 36%.

Directors reported that Western Australia is the only state to have an independent Chamber of Arts and Culture, which is able to advocate without fear on behalf of the sector. Many would like a similar organisation in their own state.

"Give, get or get off"

The expectations of directors' contribution to culture and arts organisations were also significantly different to most other industries. There was a much greater expectation that directors would volunteer their skills, donate, and raise donations from their contacts. Only 4% of directors for these organisations report being paid, compared with the average of 13% for all directors.

Furthermore, 64% of directors in the culture and arts sector made a donation to their organisation, compared with 39% of all directors. The amount donated varied from $100 to $50,000 and the median donation was $1,000. In one of our focus groups there was an in-depth conversation on the pros and cons of the "American system" of governance in the arts, in which the boards consist of 30 or more members who are generally expected to donate and raise funds. Typically, these boards have a sub-group of the board (6 - 8 members) who make the decisions.

Those with experience of these structures were very keen to see them introduced in Australia, but there was also comments from directors who preferred to see fundraising and governance separated. The culture and the arts sector was seen as more vulnerable than others to influence by funders, and they noted the potential for funders to promote or insist on certain types of arts being pursued.

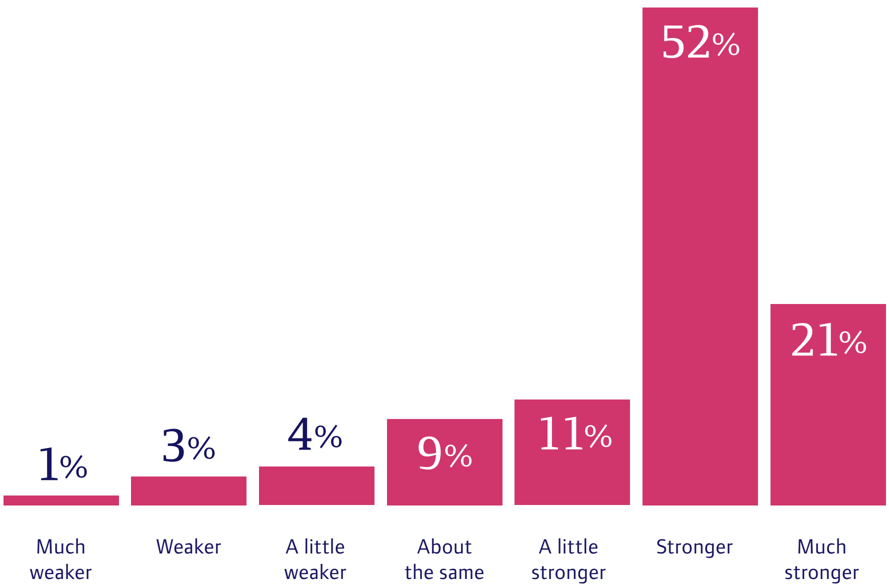
Other issues

Reports of mergers were lower for this sector. Only 15% of boards have discussed a merger and 2% are currently undertaking a merger, compared with 33% and 7% for the NFP sector as a whole.

Despite the challenges seen in the sector, directors were optimistic about the future of their organisations. More than half of directors (52%) expect their organisation to be stronger in 12 months time and 21% believe it will be much stronger. In total, only 8% believed their organisation would be a little weaker or much weaker.

Directors' expectations about their organisation in three years from now

(n = 141)



8.

Federated organisations – full of complexities

In seeking to explore federated structures, we recognised that there may be confusion as to what defined a federation. In Australia, federated structures typically have state, territory and national organisations as part of the federation, although the federation can be broader.

Many federations work very effectively, while others have found that the structure inhibits their achievement of the overarching purpose and have moved to unitary structures.

The survey asked: "Does this NFP form part of a formal federated structure of similar organisations – either as a peak body or member? A federated structure is a formal network of organisations that can include a mixture of national, state and local organisations that are individually incorporated and autonomous but work together for a common purpose."

Key issues

Federations are complex with dynamic relationships and, directors noted that one of the key challenges is to deal with changes in these relationships over time. The stability and utility of the federation is affected by changes in its operating environment, such as a need to shift from dealing with state governments to advocating at a national level.

It is also influenced by internal changes, including the balance of resources or power of individual members. Essentially, it is in balance when all members need each other. If one member believes it is stronger on its own, or if the peak body feels it takes too much control, then the dynamics become unbalanced and the federation fails to achieve its goals.

"State peak body of federated associations that also has a national peak body."

"One of a number of member organisations owned by a religious congregation."

"This NFP is global, it has 50 member nations."

There are many different forms of federation

Director tips on federated structures

Directors who were involved in federated structures gave a range of suggestions on how to make such structures work effectively. These suggestions ranged from relatively simple to more complex issues, and many with a theme around good collaboration and communication:

- Ensure that the missions of the member organisations are aligned and be vigilant for those that may be taking a new direction. If a member chooses a new direction, the federation may use the opportunity to update its own mission and follow, or it may be more beneficial for the member to leave.
- Clearly define the roles of the member organisations and the peak body. Federations are distributed leadership models and all stakeholders need to be clear about which decisions will be made by whom.
- Ensure the model of resource distribution is clear and aligned with performance measures. Establish well-defined and agreed timetables, and a process for reviewing resource allocations.
- Take a formal approach to planning and implementing conflict resolution.
- Identify the areas in which economies of scale can be achieved and then encourage specialisation. Be aware of the tendency for member organisations to take back local operations and thereby reduce efficiencies. Establish clear service agreements and accountability.

"I spend a lot of my time just trying to keep the organisation stable and on track, and keep people focused on what we are there to achieve and not on the politics."

Take a formal approach to planning and implementing conflict resolution.

- Ensure a culture of open communication, respect and collaboration is embodied in the values of the federation and role modelled by the boards and senior leadership of all organisations.
- Actively build skills in collaboration at all levels of the organisations.
- Focus on internal communications so that all members and the peak body see the work of each participant and focus on building skills in collaboration.
- Allow for local differences and have realistic expectations of consistency of implementation at the front line.
- Decentralise decisions, where possible, to allow management and staff in member organisations to feel personally responsible for outcomes achieved.

Despite the ambiguities surrounding federated structures, they are a key component of the NFP landscape, with further research warranted.

Actively build skills in collaboration at all levels of the organisations.

"…the arms and the legs create the head, but then the head feels like it doesn't need the arms and legs and takes off on its own, and then realises it doesn't have the arms and legs to do anything. Or sometimes the arms chop off the head and then no one knows which way to go."

The research method and sample

Research method

The 2015 study involved:

- Ten focus groups conducted with a total of over 60 directors in Perth, Launceston, Hobart, Melbourne, Canberra and Sydney. Three discussed general governance issues, three discussed governance in the culture and the arts sector, two discussed mergers, two discussed governance of organisations forming part of a federation.
- An online survey emailed to over 30,000 members during July 2015.

The survey sample

The profile of respondents to the 2015 study was very similar to that of the 2014 and 2013 studies.

A total of 2,976 people responded to the survey. Of these, 2,755 were current non-executive directors of NFPs.

There is no data available on the distribution of income of Australian NFPs. Data from the ACNC on charities provides some basis for comparison of our sample and shows that the findings in this report mostly represent the views of directors of medium, large and very large NFPs.

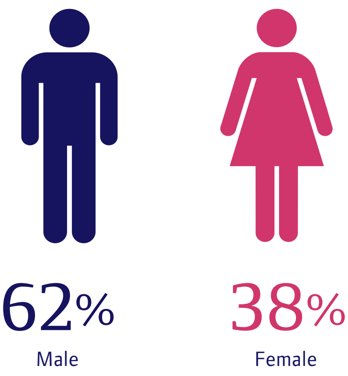
Our analysis included examination of responses by size and we comment on the results for very small and small charities where they differ.

Size categories

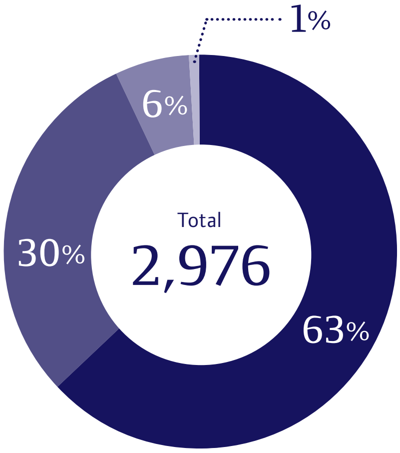
	Income last financial year	Our respondents	ACNC charities data[9]
Very small	Under $250,000	13%	67%
Small	$250,000 to $1m	16%	16%
Medium	$1m to $5m	26%	17%
Large	$5m to $20m	24%	
Very large	$20m+	21%	

9 Knight P.A. and D.J. Gilchrist 2013 (2014) Australian Charities 2013: The First Report on Charities Registered with the ACNC, A Report for the Australian Charities and Not-for-profits Commission, Melbourne.

Gender

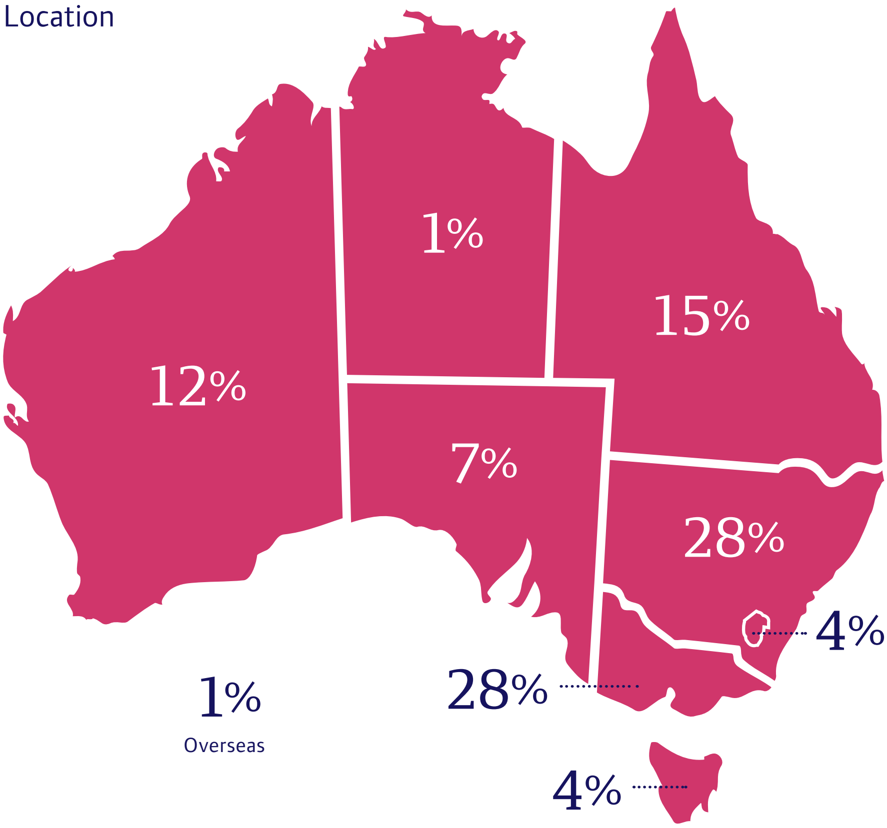


Sector



- A NFP only *(n = 1,870)*
- For-profit and NFP *(n = 885)*
- Not currently a director *(n = 177)*
- A for-profit only *(n = 44)*

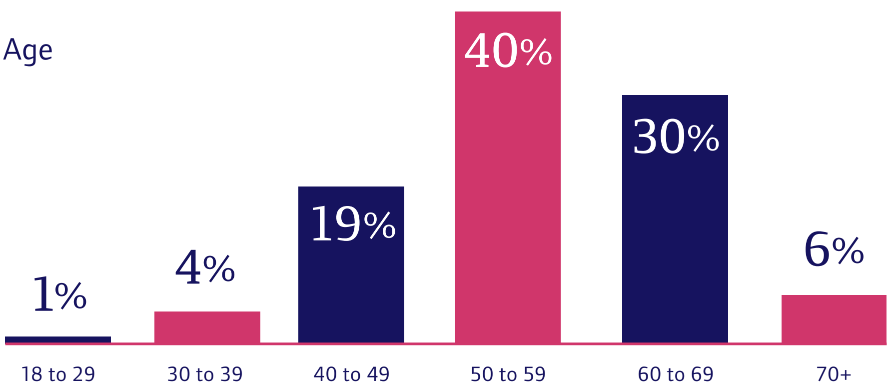
Location



Focus group sessions

	General governance	Arts sector	Mergers	Federated organisations
Launceston	X			
Hobart		X		
Canberra	X			X
Melbourne		X	X	
Sydney	X			X
Perth		X	X	

Age



About us

The Australian Institute of Company Directors is committed to excellence in governance. We make a positive impact on society and the economy through governance education, director development and advocacy. Our membership of more than 37,000 includes directors and senior leaders from business, government and the not-for-profit sectors.

We have more than 1,300 members based offshore, in countries including China, Singapore, Hong Kong, Indonesia, the United States, the United Kingdom and the United Arab Emirates.

Our principal activities include conducting professional development programs and events that build the capability of organisations, boards, directors and executives; producing publications on director and governance issues; and developing and promoting policies on issues of interest to directors. Our Governance Leadership Centre is a think tank for world-class governance, committed to driving innovation across governance and leadership and championing the latest thinking on issues affecting Australia's businesses.

We are a founding member of the Global Network of Director Institutes (GNDI), which is comprised of membership organisations for directors from Australia, the UK, US, Canada, Malaysia, New Zealand, Brazil and South Africa.

BaxterLawley

BaxterLawley
1/52 Victoria Avenue
Claremont WA 6010

Penny Knight
t: 08 9384 3366
e: penny@baxterlawley.com.au

AUSTRALIAN INSTITUTE *of* COMPANY DIRECTORS

General enquiries
t: 1300 739 119
e: contact@aicd.com.au

National Office
Level 30, 20 Bond Street
Sydney NSW 2000
t: 02 8248 6600
f: 02 8248 6633
e: contact@aicd.com.au

05145-1_15

A strong and sustainable not-for-profit (NFP) sector is important to the Australian economy and society, in many cases delivering vital services to the most vulnerable members of our community. Critically, this sector is served by those acting in directorship roles and participating in the governance of NFP organisations.

The 2015 NFP Governance and Performance Study examines the governance practices and opportunities across the NFP sector and importantly, given the diversity of the sector, shines a light on governance practices in specific sectors – this year culture and the arts.

This study is now the largest of its kind in Australia and has evolved over the years to become the primary source of information relating to NFP governance in Australia.

AUSTRALIAN INSTITUTE *of* COMPANY DIRECTORS