AUSTRALIAN INSTITUTE
of COMPANY DIRECTORS




2014

NFP GOVERNANCE AND PERFORMANCE STUDY

Examining governance practices and opportunities in Australia's NFP sector

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Supporting you and your mission

Commonwealth Bank's Not-for-Profit team are delighted to support the Australian Institute of Company Directors' NFP Governance and Performance Study 2014, the largest of its kind in Australia. This year's study once again confirms the growing significance and professionalism of the not-for-profit sector, as well as the unique challenges not-for-profit directors face. To address some of these challenges and continue to drive excellence in governance in the not-for-profit sector, we are also pleased to announce our involvement as a program partner in the new Australian Institute of Company Directors' NFP Thought Leadership Program.

The Bank has a long history of supporting the Australian communities in which we live and work, both through the Commonwealth Bank Staff Community Fund and through enduring partnerships with some of the country's leading community organisations. In fact, Commonwealth Bank has been supporting the organisations that strengthen and sustain our communities for more than 100 years.

We are working to build financial capability in the not-for-profit sector, with specialised bankers and banking solutions backed by our team's deep expertise. We also draw on the extensive resources of the wider Commonwealth Bank Group to bring our not-for-profit customers a range of value-added programs and opportunities, from events and training programs to educational guides and online tools.

In this rapidly changing environment, it's more important than ever to build the firm financial foundations necessary for sustainable success over the long term. Those challenges have, if anything, become more acute over the last 12 months. As competition for the philanthropic dollar has intensified, the demands on social enterprises from both clients and governments have increased, while the policy framework in which they operate continues to evolve.

We hope you find this year's study as revealing and thought-provoking as we have. We look forward to the opportunity to work with many of you in the year ahead.

Vanessa Nolan-Woods
General Manager – Schools and Not-for-Profit, Commonwealth Bank

We would like to thank the Commonwealth Bank for partnering on the NFP Governance and Performance Study 2014.

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Contents

Foreword by John H. C. Colvin

The not-for-profit (NFP) sector is an essential part of the Australian economy and society.

In 2012-13, according to ABS estimates, there were approximately 57,000 economically significant NFP organisations generating over $107bn a year in income and employing more than one million people – or about eight per cent of the workforce.

The 2014 NFP Governance and Performance Study is the largest and most comprehensive source of information on the governance of these NFP organisations in Australia. It answers questions about the quality of governance of our NFPs, if this is changing and how boards can improve further. It examines the complex issues of mergers and collaboration, performance measurement and the payment of directors, and identifies the key issues governments should address in supporting the sector.

In its fourth year as a national study it has received huge support from the sector. More than 2,700 current NFP directors answered the questionnaire, which is a significant increase on the number that participated in 2013. These directors are highly skilled and experienced and lead organisations from small rural community groups to national organisations with turnover above $100m.

In addition to providing insight into the governance of the NFP sector as a whole, this year the study includes detailed information in three specialist areas. For the first time, we examine NFP governance from the perspective of senior executives employed by NFP organisations. We also include specific analysis of issues faced by boards in the education and aged care sectors.

Company Directors is absolutely committed to providing valuable resources for the NFP sector and we trust this report will inform governance practice into the future.

John H. C. Colvin
Chief Executive Officer and Managing Director

2014
Key Findings

1. NFP governance continues to evolve
2. Boards target areas for future development
3. Collaboration and mergers on the agenda
4. Boards want better performance indicators
5. Relationships between boards and CEOs are strong
6. Education – striving to be 'top of class'
7. Aged care responding to constant change
8. Directors' contribution is significant
9. Certainty in government policy is needed

1

NFP governance continues to evolve

Over 85 per cent of non-executive directors (NEDs) believe that the governance of their organisation is better now than it was three years ago. A similar proportion believe the overall quality of governance in the sector has improved.

Directors in our focus groups commented on the increasing complexity in operating environments and growing demands on their organisations and their directors, yet they believe that their boards had risen to these challenges. Many of these challenges are summarised in this report.

Governance of the NFP sector has been under scrutiny by government, the sector itself and the wider community for at least ten years. Some had concerns (or assumed) that NFP governance was 'below par' when compared with that of the for-profit sector.[1]

In 2010, the Productivity Commission published its evaluation of the contribution of the NFP sector[2], which led to the introduction of the *Australian Charities and Not-for-profits Commission Act* 2012 that codified NFP governance requirements and subsequently established the Australian Charities and Not-for-profits Commission (ACNC).

This legislation was introduced to improve public trust and confidence in the NFP sector, support sustainability and innovation and enhance transparency and accountability. In addition to these overarching changes, government agencies such as the Australian Sports Commission and the Department of Social Services have been actively promoting good governance within their sectors of operation. Industry bodies, including Company Directors, have been actively conducting governance education programs and disseminating support materials.

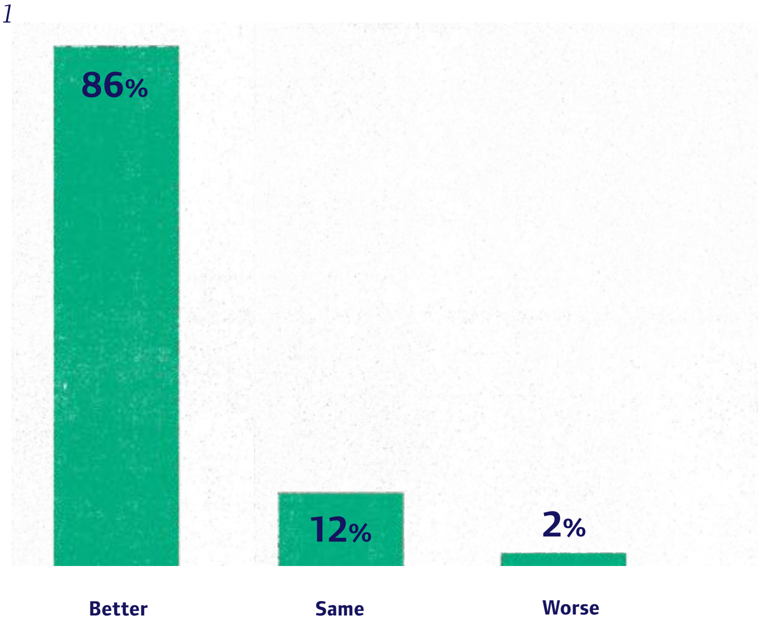
It is not possible to identify which, if any, of these activities have resulted in change, but clearly the collective focus on NFP governance has encouraged boards and individual directors to reflect on, and improve, their performance.

The 2,700 NFP directors represented in this survey work for NFPs with a combined income in 2013-14 of over $15bn.

[1] Our research over four years based on independent evaluations found no evidence that NFP governance is (or was) any worse than that of for-profit organisations of similar size.
[2] Productivity Commission 2010, Contribution of the Not-for-profit Sector, Research Report, Canberra

NEDs' views on the quality of governance compared with three years ago

n = 1,911

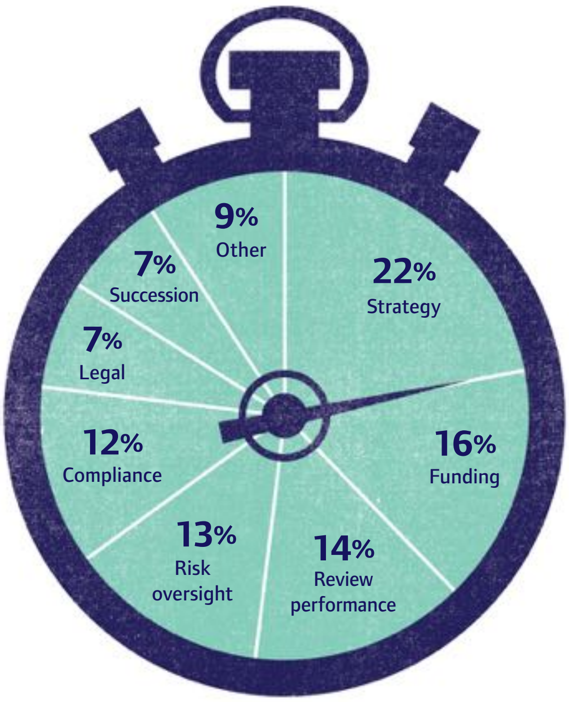


How boards are spending their time

The NEDs who responded to our 2014 survey are highly experienced in the governance of both NFP and for-profit organisations. Their work for NFPs is diverse and their time is divided between strategy (22 per cent), managing funding (16 per cent), reviewing performance (14 per cent), risk oversight (13 per cent) and compliance (12 per cent).

Proportion of time spent on governance activities

n = 2,303



Governance performance varies by size of organisation – suggesting appropriate governance practices

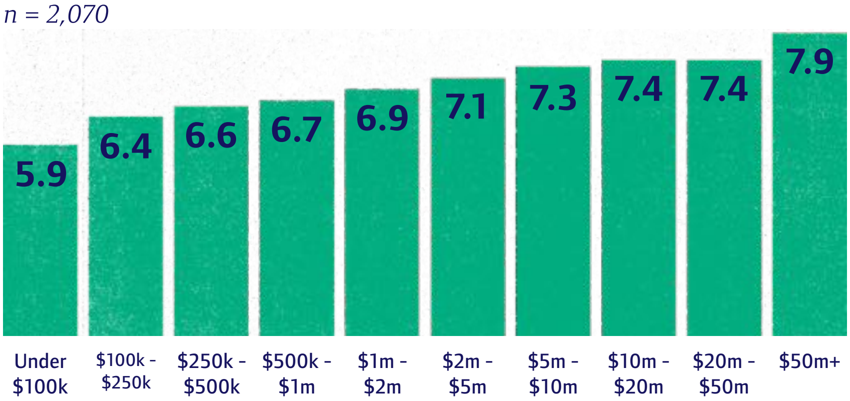
The results from this year's study confirm that directors' rating of governance performance varies with the size of the organisation. Directors in our focus groups believe that, for the most part, this reflects the less sophisticated governance requirements of smaller entities, rather than smaller entities having governance standards below those necessary to deliver on their mission or purpose.

The average score of the smallest NFPs was 5.9 out of 10, indicating that governance standards are still meeting basic expectations[3].

Although these results show that the quality of performance varies with income, income is only a proxy measure of organisation size and risk. Governance requirements must be commensurate with the nature of the activity undertaken and regardless of size, NFPs operating in high-risk areas will need governance practices equivalent to much larger organisations. For example, an emergency service brigade could have an income of less than $10,000 per year, yet must have governance systems that ensure adequate training and supervision of volunteers operating in high-risk situations.

Directors' rating of governance performance by NFP income*

n = 2,070



*Rating out of 10

Size categories

	Income last financial year	Per cent of directors/NFPs
Very small	Less than $250k	14%
Small	$250k to $1m	15%
Medium	$1m to $5m	26%
Large	$5m to $20m	22%
Very Large	$20m +	23%

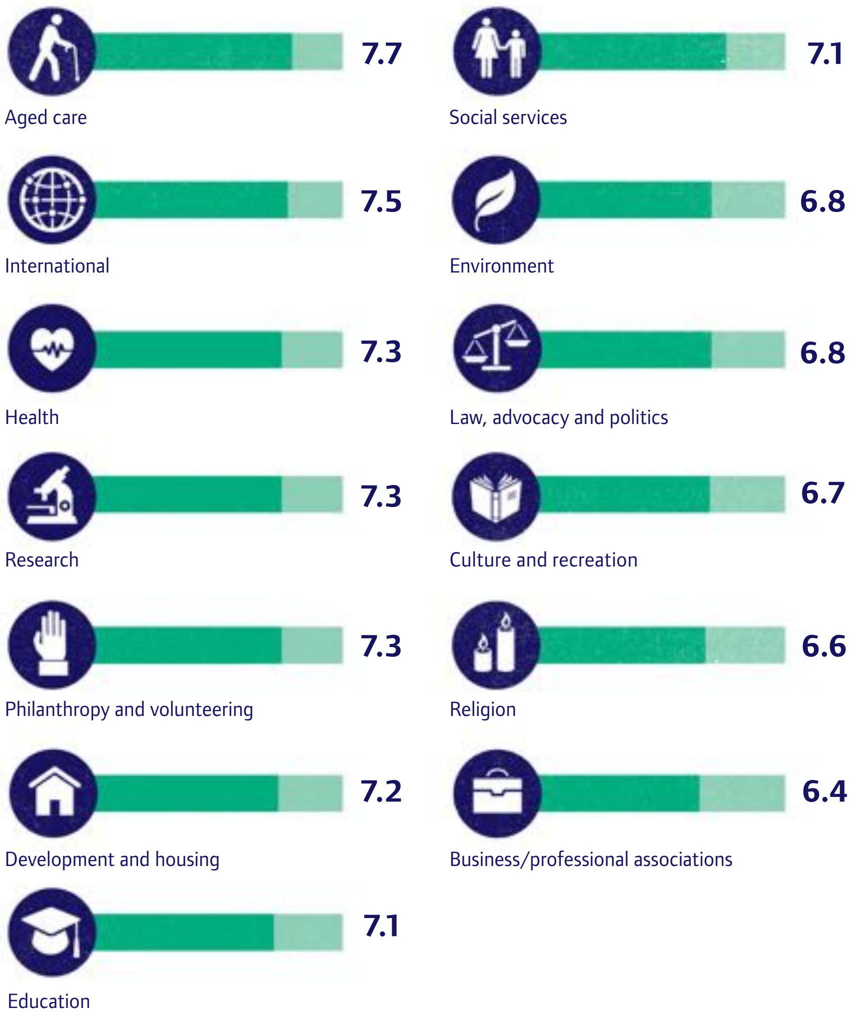
[3] Scored using a sliding scale with 0 = poor and 10 = good.

Governance performance is similar across sectors

Directors' ratings of governance performance show only minor variation across sectors. The highest ratings were for organisations operating in the aged care and international sectors, and the lowest for those in culture and recreation, religion, and business and professional associations. These results may reflect variations in the complexity and risk of operations but also the average size of NFPs, which differs considerably. For example, the average annual income of aged care organisations was $23m compared with $8.6m for religious organisations and $7.1m for those in the culture and recreation sector.

Directors' rating of governance performance by sector*

n = 2,086



*Rating out of 10

2

Boards target areas for future development

To further improve governance, half of all NEDs and executives believe their boards should focus on attracting more highly skilled directors, and 40 per cent of executives want further improvement in governance skills.

One in five NEDs and 29 per cent of executives want better chairmanship, highlighting both the high expectations of this role and the need for some chairs to further improve their skills or performance. One in five NEDs believe their governance would be improved with a more highly skilled CEO.

About a third of both NEDs and executives believe their board should be more innovative and one in five believe it should better manage risk.

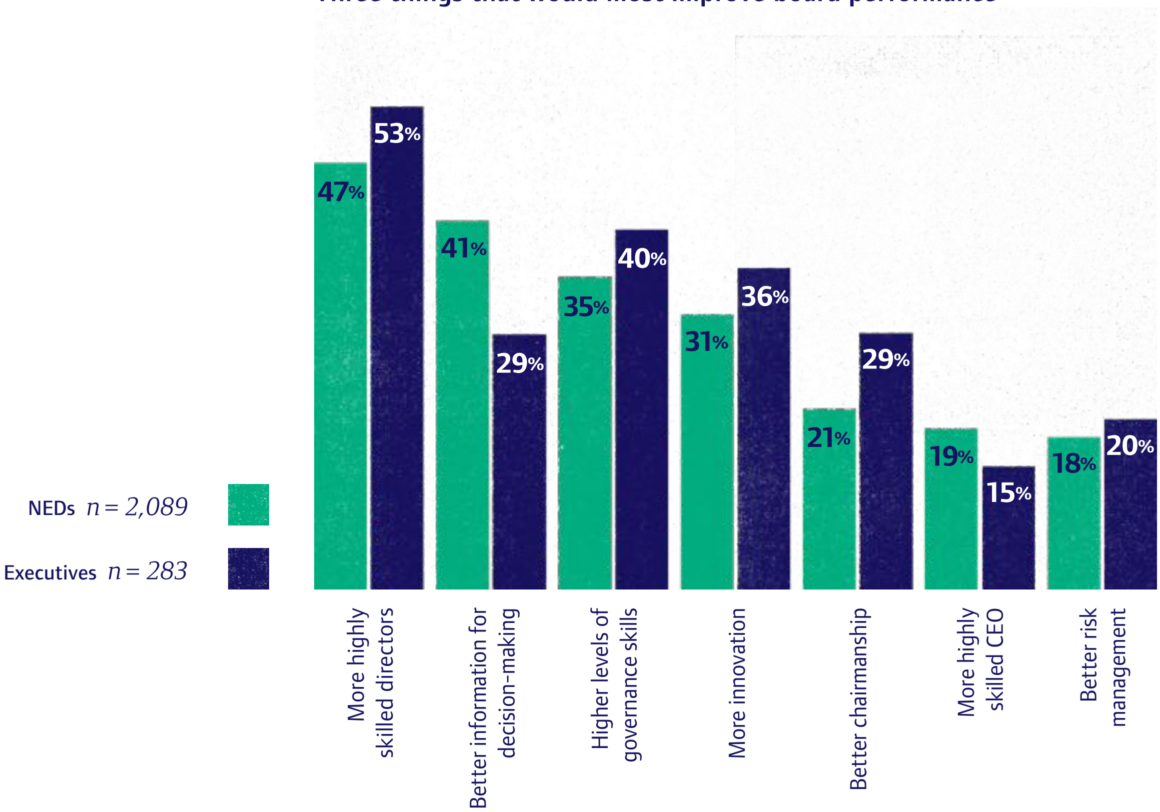
In the discussion groups these two board attributes (innovation and risk) were seen as strongly related.

The largest difference between NEDs' and executives' views on priorities for improvement were related to board information. Forty per cent of NEDs believe their board's performance would be improved with better information, whereas this was raised by only 29 per cent of executives. Nonetheless, 29 per cent of executives is a significant proportion (particularly as the provision of information to the board is a responsibility of executives) and supports the findings in Section 4 regarding directors' desire for better measures of performance.

"Our board struggles to be innovative really. We have an older crew, a bit risk averse – 'the we haven't done that before' types."

"I want my board to challenge me – to give me ideas."

Three things that would most improve board performance



Definitions of terms

Non-executive directors (NEDs) are directors who are not paid employees of the organisation.

An independent NED is one who is free from any relationship that could materially interfere with the exercise of their judgement.

Executives are employees of the organisation but are not voting members of the board.

Executive directors are both employees of the organisation and voting members of the board. For example, a CEO or Managing Director may be an executive director.

Definitions are not clear among NFP directors. Forty per cent of those classifying themselves as executive directors in the survey were not voting members of the board.

In this study, the term 'executive' includes both executive directors and executives as they are both employees of the organisation.

Over a third of NFPs are planning to change one or more of their governance documents in the next year

This year's survey shows the extent to which governance structures of NFPs are evolving. Approximately one third of boards are planning revisions to their organisation's constitution (or equivalent document, such as statement of purpose, rules, articles of association) in the next 12 months. In most cases, this is driven by a need to revise outdated procedures; improve organisational agility; or change mission or purpose in response to changing client needs; or in response to changing legal obligations.

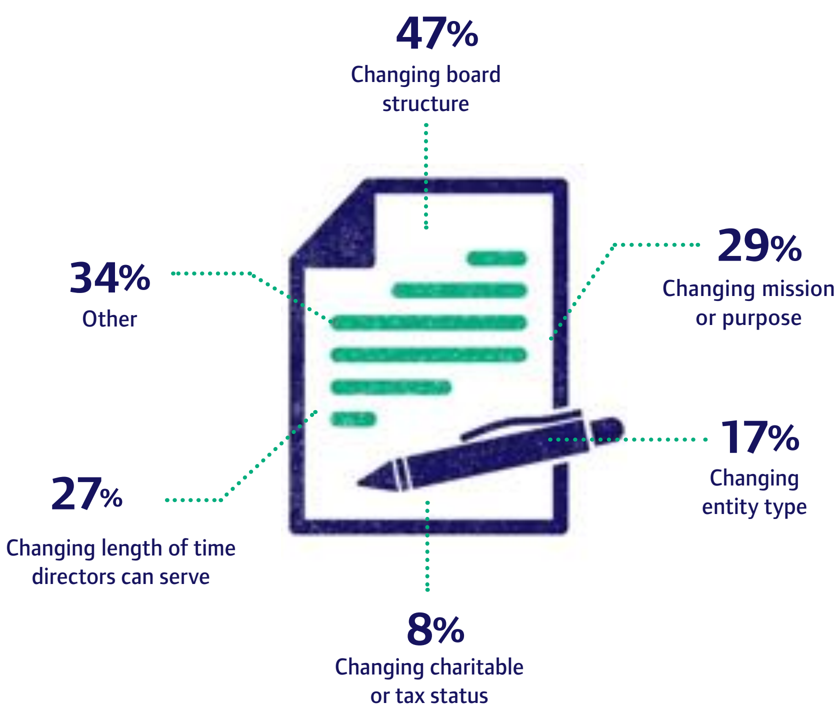
Nearly half of those implementing changes will be amending their board structure, for example to change from a representative model to a skills based or independent board. Twenty nine per cent are revising their mission or purpose and a similar number will be changing the length of time directors can serve on the board.

Interestingly, 17 per cent of boards are seeking to change their legal structure. Sixty per cent of NFPs are currently Incorporated Associations, 12 per cent Unincorporated Associations and 14 per cent are Companies Limited by Guarantee. Intention to change legal structure did not appear to be correlated to size.

"We are moving from an Incorporated Association to a Company Limited by Guarantee mostly because the Companies Act is a much more settled law… and we won't have to change again."

Planned changes to constitution in the next year

n = 699



Note: Total does not add to 100 per cent due to multiple responses allowed

"The constitution was written 20 years ago, when we had about 20 clients and we wanted them to be members. Now that we have over 350 clients it's not functional."

Reasons given for changing the constitution:

- Moving from a federation of state bodies to a single national organisation
- Becoming a Company Limited by Guarantee
- To reduce directors' terms on the board
- To comply with changes in government regulations
- Amalgamation and winding up of other entities
- Tidying up the constitution and modernising
- Changing the definition of membership
- Provide greater clarity on board governance roles and responsibilities
- General refresh
- Remuneration policy of directors
- Change to our mission or purpose
- Allowing the CEO to join the board
- To enable merger

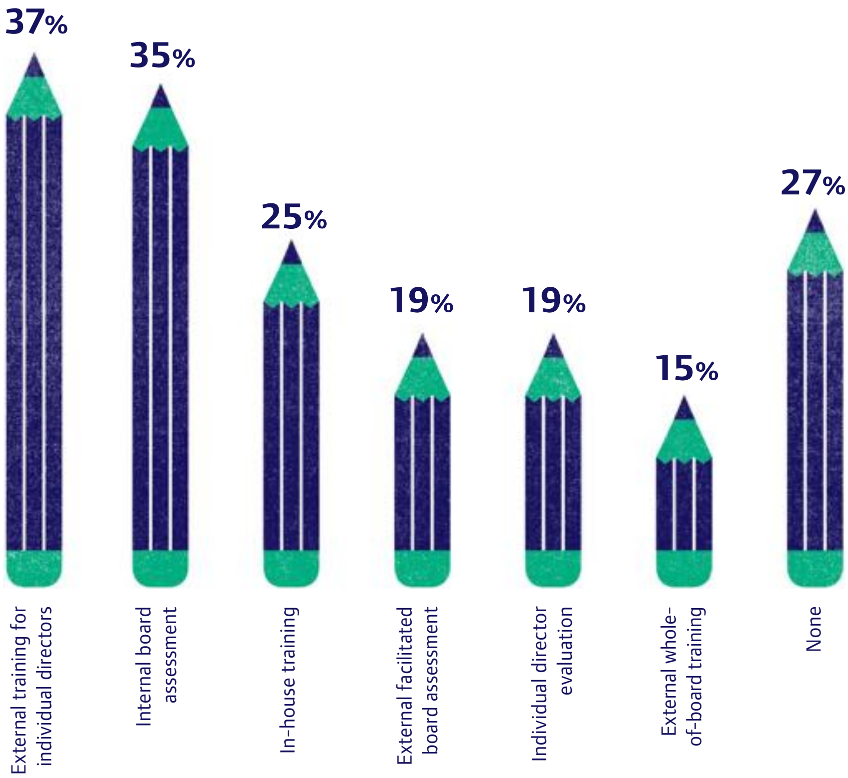
Boards continue to invest in formal professional development

As in previous years, nearly three quarters of NFP NEDs reported that their boards had undertaken one or more forms of formal professional development in the last year.

- 37 per cent reported individual directors had undertaken external training.
- 35 per cent reported that their board undertook an internal assessment.
- 25 per cent said that they had in-house training.
- 19 per cent said their board had an externally facilitated board assessment and the same said that individual directors had been evaluated.
- Only 15 per cent had external whole-of-board training.

Professional development undertaken in the last year

n = 2,064



Medium and large NFPs struggle most to provide professional development

There is a clear correlation between organisational income and the extent of formal professional development (PD). Only half of directors of organisations with income below $500,000 stated their boards had undertaken any PD, and in most cases this was external training for individual directors or in-house assessment or instruction. In comparison, 90 per cent of those working with very large NFPs said their board had undertaken PD and on average they had undertaken twice as many types of development programs as the small organisations.

Directors in focus groups explained that small organisations have little or no budget for PD, but also less need for advanced governance skills. For this audience, there is a need for short, simple training sessions and online seminars that cover the basic governance requirements. Very large organisations have much more complex governance needs but are also more likely to have the budget to fund individual or board PD programs.

However, directors felt that it is the medium and large organisations (between $1m and $20m income) that struggle most to meet their ongoing needs for enhancing performance. This group can have complex governance needs but continue to find it very difficult to justify the costs and time requirements to stakeholders and even the board itself. There was also a view expressed that the culture of the organisation has a bearing on the acceptability of the board paying for PD. In some organisations, spending any money on the board is 'not done' and directors are expected to volunteer their time and pay their own expenses, including PD.

Some directors also commented that many funders or donors do not want their resources allocated to these activities and this attitude is hard to shift.

3

Collaboration and mergers on the agenda

NFPs show a high degree of collaboration

Directors attending focus groups over the last three years have often commented on the number of NFP organisations in Australia, the capacity of the community to accommodate so many small entities, and whether there should be encouragement from government for NFPs to merge. In some sectors, notably aged care, disability and community housing, pressure to merge is arising from economic factors such as staff and infrastructure costs, and costs of compliance.

This year, we asked directors if their organisations collaborate with other NFPs, how they collaborate and whether a merger is something they have considered.

The results reveal that NFPs are actively collaborating and partnering with other NFPs to deliver services across the sector.

Two-thirds of directors said their NFP works with others to advocate for their sector or to service beneficiaries, and more than a third have an agreement/memorandum of understanding (MOU) to refer or service clients (this was highest among NFPs in the health sector).

A quarter of directors reported their NFP shares resources, such as buildings and equipment and 18 per cent share back-office costs. Over 40 per cent report subcontracting the provision of some services to other NFPs and 15 per cent outsource their back office functions to another NFP for which they pay a fee.

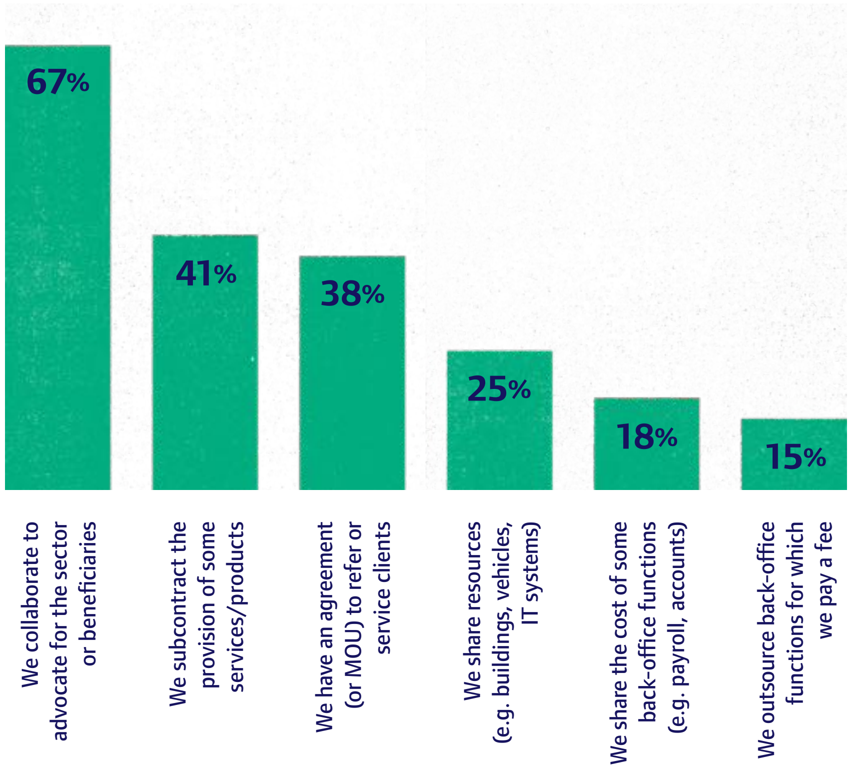
There are slightly higher proportions of NFPs collaborating with others among organisations with income less than $250,000 and between $2m and $10m. Collaboration was also highest among NFPs operating in the education, health and social services sectors.

Example of how NFPs work collaboratively

An NFP in the disability sector with a turnover over $30m invests in a new accounting and payroll system, and associated staff training.
It recovers some of this cost by providing 'fee for service' bookkeeping and/or payroll functions to six NFPs, each with income below $2m.

Extent of collaboration with other NFPs

n = 1,936



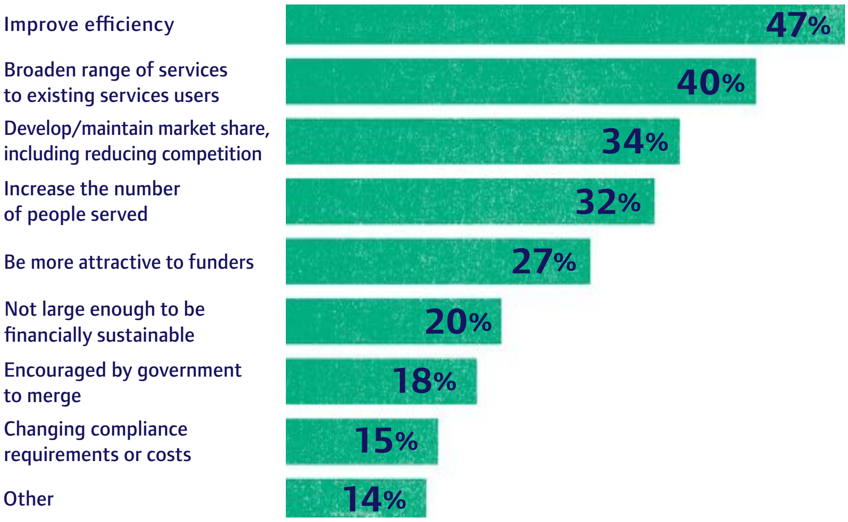
Mergers are being discussed by 30 per cent of boards

Thirty per cent of directors said their boards had discussed or taken action to merge their NFP with another organisation in the last year. Merger discussions were most common in the large NFPs, particularly those with income above $10m or operating in the social services, development or housing sectors. Of the 259 directors of NFPs in social services, more than 50 per cent said that their board had discussed a merger. Similarly, over half of the 62 directors of NFPs in development and housing had discussed a merger.

The main reasons to consider merger were to improve existing services, efficiency or broaden the range of services to existing service users. Twenty seven per cent said they had considered merger in order to be more attractive to funders and 18 per cent in response to encouragement by government.

Reasons for considering a merger

n = 627



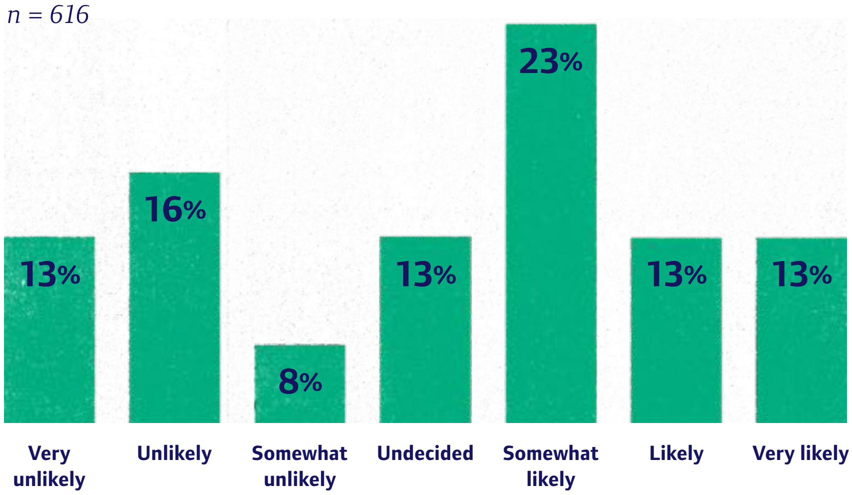
About a quarter of boards that discussed merger expect it will happen in the next two years

Undertaking a merger of organisations, whether for-profit or NFP, is complex, expensive and risky. Only a quarter of those that discussed merger, or eight per cent of all directors, believe it is likely or very likely that their organisation will complete the transaction.

Several focus group participants had recent experience of successful mergers or were currently involved in merger negotiations. They believe the key factors to achieve success are thorough due diligence investigations prior to beginning initial undertakings, a shared mission and/or common beneficiary groups, sufficient financial resources to support change, cultural compatibility, strong leadership and stakeholder support. In many cases, a takeover of a smaller enterprise by a much larger one is easier to arrange and complete, as are mergers strongly supported by a key funder.

Likelihood of merger in the next two years

n = 616



4

Boards want better performance indicators

Measuring mission effectiveness

The overall performance of an NFP is determined by how well it achieves its mission or purpose, yet only 50 per cent of directors believe that their organisation measures this effectively.

Performance measurement can be a complex and enduring problem. Essentially, NFP boards need two types of information:

1) They need regular operational reports that tell them if the organisation is efficient, effective and sustainable. Collection and analysis of this information is straightforward and common to NFP and for-profit organisations, and across sectors of operation.

2) NFP boards also need information that tells them if their strategy is achieving the organisation's purpose or mission. For NFPs with tightly defined missions, or for which results can be seen within short time frames, this is comparatively easy. NFPs in education can measure student numbers and achievement; arts and sports bodies can measure the extent of participation; and fundraising organisations can measure the net amount of funds raised.

For NFPs in other areas, measuring their success is much more complex. Researchers in the disability, aged care, homelessness and health sectors have long sought definitive measures of quality of life or wellbeing. Considerable work has also been completed on ways to measure social return on investment in order to choose between alternative investment options. These assessment frameworks have yet to result in evaluation structures that produce consistent results when used by different evaluators. Further, some NFPs are tackling complex problems that do not have established or even agreed solutions to test, or which will take 20 years or more to observe substantive change. Others are providing services for which outcomes may never be quantifiable. Examples of these NFPs include those working in overcoming indigenous disadvantage, homelessness, and drug and alcohol abuse and advancing religion.

Directors in our focus groups commented that boards operating in these sectors must rely on proxy measures and the judgement of experienced directors and management. They also noted that absence of hard outcome measures can result in boards focusing too much on the operations or activities (the things that can be measured); and the difficulty in having constructive conversations of alternative strategies when there is little objective evidence to evaluate alternatives.

"It keeps me awake at night. I don't know if what we provide will have an effect in the long run."

"Our outcomes are very difficult to measure and even the idea of measuring outcomes can be contentious."

The complex problem of measuring achievement of mission is not fully captured in the results from the survey. The data does suggest that organisations with income below $1m are twice as likely as larger organisations to state that they were ineffective at measuring their mission. It also shows that directors in the education, international aid, philanthropy and research sectors gave their organisations higher ratings for measurement of mission.

Directors want more non-financial information

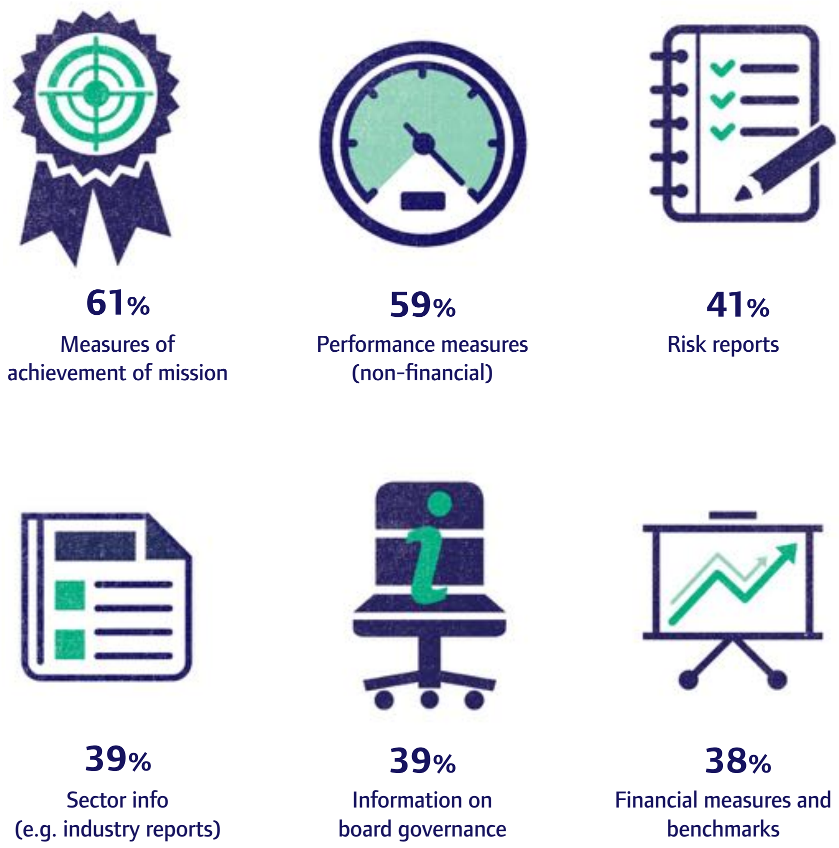
Approximately 60 per cent of directors want more measures of achievement of their mission and half want more non-financial performance measures in general. About 40 per cent specifically want more information about risk, data on the sector and information on achievement of financial benchmarks.

In the focus groups, the executive directors were supportive of providing boards with what they need, but commented that NEDs are not always aware of the resources required to provide data and that in some cases, the board did not use the results. They also gave examples of preparing papers based on past practices and an assumption that 'more information is better' rather than what is most effective and efficient to produce for today's decision-making.

Boards should consider undertaking an annual audit of the information provided and allocate time in the agenda to discuss the use of this information and alternatives.

Information the board should have more of

n = 1,837



5

Relationships between boards and CEOs are strong

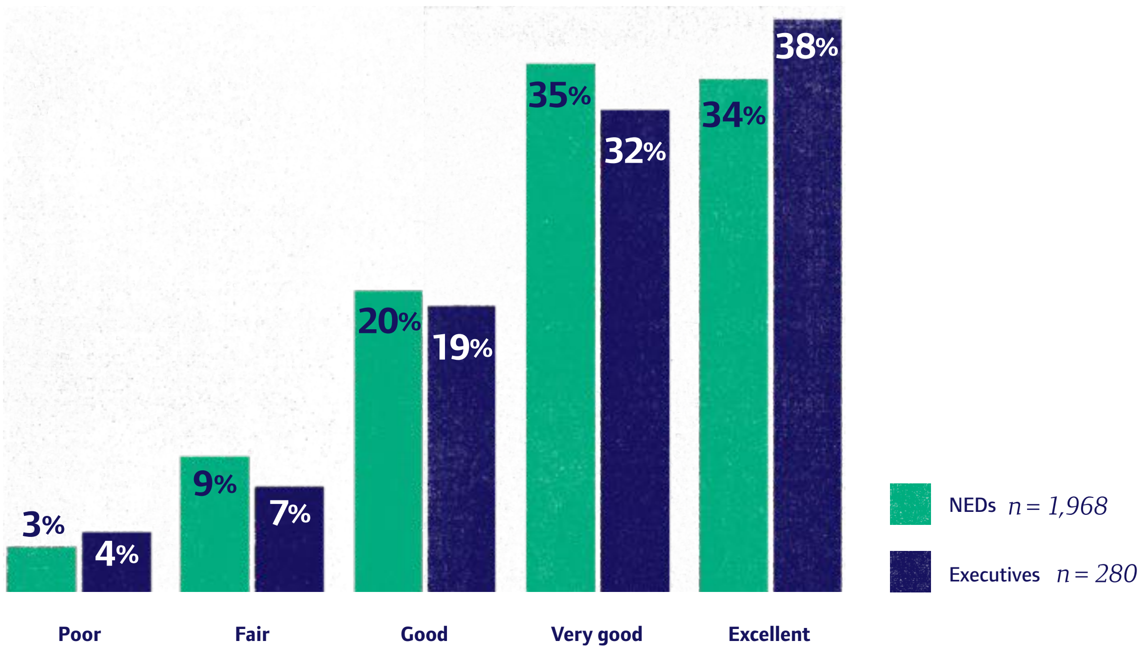
More than 60 per cent of NEDs report that the relationship between the boards they serve on and CEOs is very good or excellent. Only a very small percentage of both NEDs and executives believed that relationships between the CEO and the board were poor.

Overall, the executives in our focus groups were very positive about, and grateful for, the role their boards play. They were also particularly aware of the dedication and the hours contributed by board chairs – in many cases chairs were contributing more than twice as much time as other board members.

What would you say to the NEDs on your board?

"Thanks for supporting me, for providing a sounding board. And, of course, for the skills and experience they bring which we can't do without."

The relationship between the CEO and board



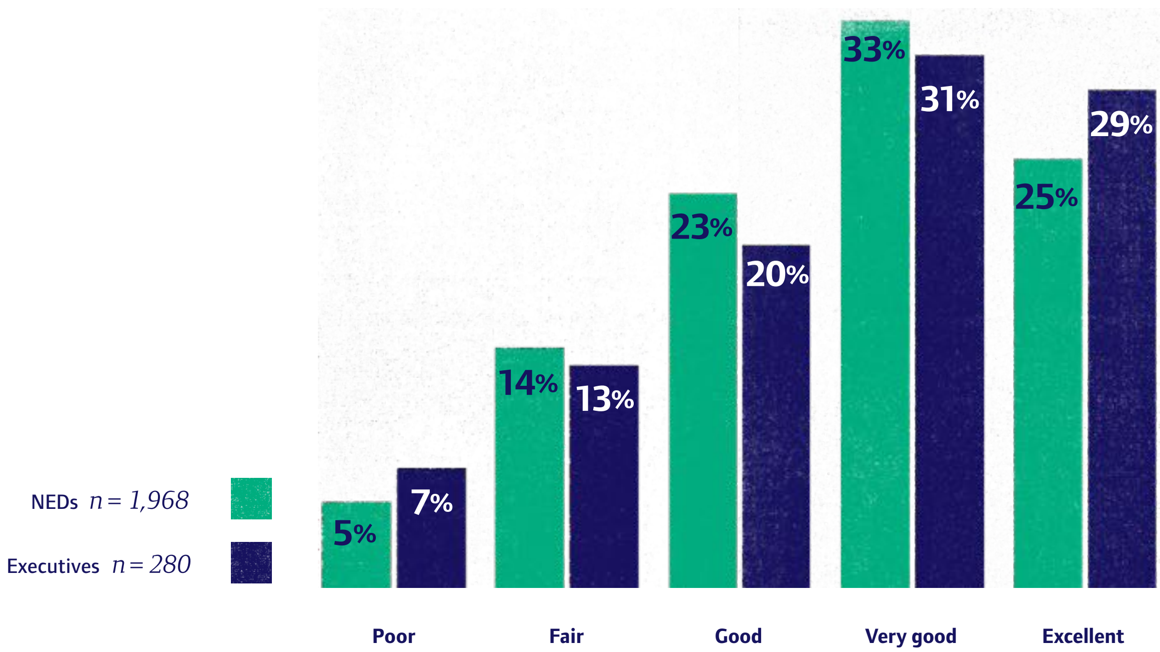
Role clarity

An issue that is often raised in governance discussions and director education programs is the need for clarity in regard to the role of the board and the role of the executive. Although the majority of directors believed that role clarity was good to excellent, 19 per cent of NEDs and 20 per cent of executives believe that the definition of their board and CEO roles is only fair or poor. Lack of role clarity can have a significant impact on the performance of the board and relationships between members. For boards that have poor or only fair role clarity, discussing and agreeing the boundaries between board and CEO duties should be a priority.

Directors in our focus groups told 'war stories' of situations where conflict was so severe it resulted in director and CEO resignations. In nearly all cases this conflict was caused by a lack of understanding of how to operate in an environment of shared responsibility and delegations of authority. They gave examples of both chairs and CEOs who behaved as if they were running their own business, not considering alternative opinions, withholding information and issuing orders. They also gave examples of the opposite, that is, chairs or boards that were passive or disengaged, and CEOs unwilling to make operational decisions without approval from the board. Finally, there were stories of directors or CEOs who simply lacked the interpersonal skills and respect for others needed to work in collaborative environments.

Directors mentioned that the most effective solution to this problem is often external whole-of-board evaluation or training but noted it can be difficult to get a highly autocratic CEO or chair to agree to participate. Occasional whole-of-board evaluations can be useful for all boards as members' understanding of roles can change over time.

Clarity of board and CEO roles



Executives want directors with better sector knowledge and balanced risk-taking

NEDs and executives responding to the survey generally agree on the areas of strength and weakness of their boards. However, when tested in the focus groups, executives said they would like NEDs to invest more in understanding the sector of their operations and approach to risk[4]. Several executives, particularly those working in human services and education, stated that the commercial experience of their NEDs was invaluable, but would be better applied if they had a greater understanding of how their sector works. They encouraged NEDs to visit operations, engage with staff and see the day-to-day service delivery for themselves, and gave examples of directors who had only ever visited the boardroom.

Executives' concerns in regard to their boards' governance of risk were specific to their organisation and its current operating environment. Some felt their boards were overly focused on risk and that strategies were too conservative and not sufficiently innovative, while others felt that their board had little understanding of key risks or focused on the wrong risks. It is possible that directors' level of sector knowledge and risk appetite are related.

Both executives and NEDs are interested in sharing their knowledge and in having more open and challenging conversations to improve their common understanding of the organisation and build greater consensus about its direction. They believe this will improve the quality of strategic planning and particularly its implementation. This is something chairs may wish to consider when determining agendas and can be built into the board routines.

Some boards regularly meet in different service locations, incorporate tours or demonstrations of new equipment and bring board members into staff briefings and training. Others have separate informal 'fireside chats' outside regular meeting times so concerns, ideas and comments can be shared but not formally recorded.

Overall performance of my board

Executives
6.8 out of 10

Non-executive directors
7.0 out of 10

[4] These differences in views are reflected in the survey data, but are not statistically significant.

6

Education — striving to be 'top of class'

Organisations providing education services are the single largest category of NFPs in terms of income, employment and community reach[5]. These organisations include pre-schools, primary and secondary schools, and tertiary and vocational education providers. It also includes supporting organisations such as school associations/entities (e.g. Scouts) and some health promotion charities.

This year our study focused on the unique governance challenges of a subset of this group – independent (private) primary and secondary schools and colleges.

The issue of school governance is increasing in priority in the public sector. In the last five years, state governments, notably Victoria and Western Australia have introduced major reforms that enable public (government) schools to choose to be governed locally by their boards and principals rather than an Education Department. This is also a major policy direction of the Commonwealth government. There are now hundreds of 'independent public schools' in Australia taking decisions about resource allocation, curriculum and staffing. This has created huge changes in stakeholder relationships. The success of this policy will be highly dependent on the governance skills of local boards. Although independent public schools do not have the full range of responsibilities of their peers in the private sector, many of the issues they face are similar.

Independent school governance

The structure of school boards varies considerably. Some are representative boards with defined positions for past students, parents, church leaders and appointed directors. Others may have boards with all external appointees.

The time requirements of a school board can be considerable. A quarter of NEDs spend between two and five days per month on their directorship duties and 10 per cent report spending more than five days a month. A large majority (76 per cent) are not paid, but 11 stated they received directors' fees. These ranged from $250 to $55,000, with the average $17,600.

Members of our focus groups raised a number of unique challenges faced by schools and their boards. These were ranked from one to five in terms of their importance in the survey.

There are approximately 2,700 independent schools across Australia, of which about 1,000 are affiliated with the Catholic Church.

[5] ABS 5256.0 – Australian National Accounts: Non-profit Institutions Satellite Account 2012-13

Priorities of school boards

Managing the school's reputation

A school's most important asset is its reputation, which can take years to build, but be lost in a day. A good reputation attracts the best teachers, students and community support, as well as steady donations. Top academic (and sometimes sporting) results have always been important but the introduction of national testing and publication of comparative results online has made performance increasingly transparent and is putting more pressure on schools.

A school's reputation is also strongly influenced by the quality of its principal who is primarily responsible for building a culture of high standards and a loyal and stable workforce. He or she must also be able to create strong and resilient relationships with students, parents and the school's external stakeholders. Any souring of relationships can have a swift negative effect on the school.

Other risks to reputation are related to the size of the student and staff populations and the possibility of criminal or corrupt behaviour and long court processes. These risks include fraud, drugs, indecent assault, and sexual abuse. Directors recently attending governance forums have been told to plan what they will do when (not if) their school is involved in a case of child sexual abuse and how they will handle the impact on reputation, whether substantiated or not. The liability issues for abuse cases can extend for more than 50 years after a student has left school.

Funding uncertainty

Changes to the funding of private schools has been on and off the Commonwealth government's agenda several times in recent years. School infrastructure can take years to plan and fund, and combined with changes to curriculum have created significant uncertainty and stalled some investment.

Increasing own source income

Schools are increasingly seeking major donations and bequests from past students and parents of current students for infrastructure or scholarship funds. Schools with male students (either single sex or co-ed) were reported to receive more than double the donations received by girls' schools.

Managing parent engagement

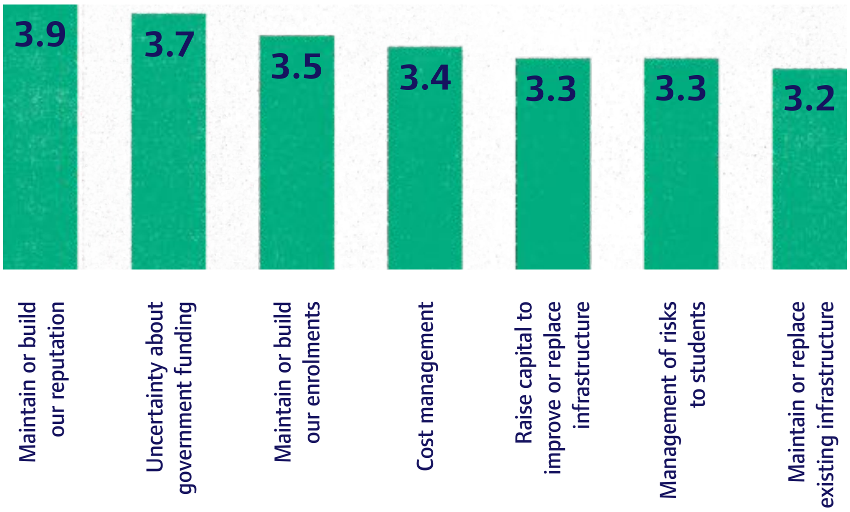
School directors noted that the boundaries between school and home have become increasing blurred. Parents can be exceptionally demanding but valuable stakeholders and some schools have developed education and engagement programs to make it easier for parents to engage in the school, while providing boundaries for 'helicopter' parents. At the same time, schools are increasingly being asked to deal with complex social, emotional and behavioural problems.

Executives and NEDs generally agree on these priorities, but executives have greater focus on building enrolments, performance on academic testing and cost management.

"With the number of things that can go wrong in a school on any single day, I often wonder how she (the Principal) sleeps at night."

Five most important challenges for schools in the next three years*

n = 128



*Rating out of five

"Governments should make a commitment to a funding model beyond a year."

When asked what they want from governments, the answer from school directors was very clear. Sixty five per cent mentioned clarity of funding arrangements. Specifically, they wanted government to make a commitment to a funding model for at least five years so that they could make better decisions about investment in curriculum and curriculum support, infrastructure and staffing. A further 10 per cent requested funding not be reduced or for it to be applied equitably. The next most common request was for clarity and stability around policy in regard to curriculum and for consistency across State and Commonwealth government programs.

Two focus groups were held with directors of private schools and 300 NEDs and 32 executives of NFPs in the primary, secondary, higher and vocational education sector responded to the survey. Of these, 150 serve on the boards of independent (private) primary and secondary schools and colleges.

In our sample:

- 8 per cent were directors of schools with income of less than $1m
- 40 per cent were directors of schools with income of over $20m
- 40 per cent were directors working with schools that are registered charities and 70 per cent were working with schools that are registered as deductible gift recipients
- 6 per cent of directors were paid

On average, schools received 45 per cent of income from student fees, 26 per cent from the Commonwealth government and 16 per cent from state governments. Income was also generated through donations, commercial activities and funds invested.

7

Aged care responding to constant change

With our ageing population, the demand for aged care services in Australia is expected to double in the next 35 years[6]. In response, the Commonwealth government continues to implement major reforms to the sector, including the restructuring of support packages and funding, the expansion of consumer directed care (CDC), removal of distinctions between high and low care residential services, and revisions to aged care bond arrangements.

Directors in aged care commented most about the complexity of the system for all stakeholders, but particularly for service users, their families and service providers. CDC and individualised funding is seen as a positive policy direction and supported, but there are concerns about how this will impact providers' capacity to 'bend' service allocation at the front line to serve those most in need or deal with emergencies. This is a particular challenge for NFPs whose missions are values based.

Maintaining financial stability and compliance with government requirements are the highest priorities for providers of aged care services. Fundamental changes in the cost of service has pushed the minimum viable size of an independent residential aged care facility to more than 100 beds; others suggested it is higher. Directors spoke of the need for aged care providers to grow and 40 per cent stated that their board had discussed a merger in the last 12 months and half expect it to happen. The main reason for merger was to ensure their own organisation's financially sustainability (52 per cent) or because they had been approached by smaller providers.

"Strategically it is difficult to plan services to meet community needs when the goal posts are continually changed with changes in legislation, government whims, and not enough money in the system available into the future."

[6] Centre of Excellence of Population Ageing Research 2014/01

Two focus groups were held with directors of NFPs operating in the aged care sector and 135 NEDs and nine executives answered specific survey questions related to aged care governance in the survey. Aged care organisations are typically large. In our sample:

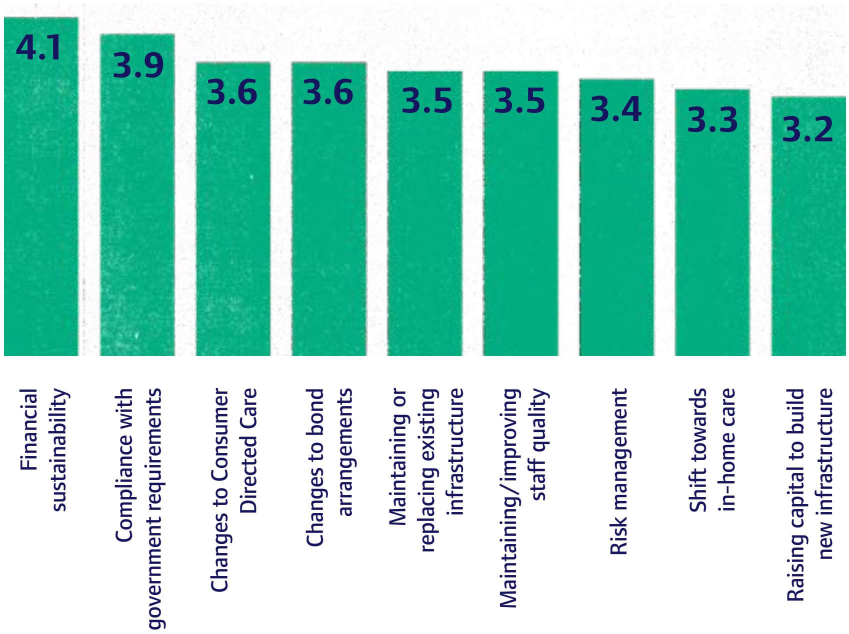
- Nearly a quarter of NEDs work with aged care organisations with income of $10m to $50m and a third served organisations with income over $50m
- Over 70 per cent of these organisations are charities
- 15 per cent of NEDs are paid. The highest reported directors fee was $88,000 and the average $33,000

"The government needs to look long, long, long term to work out what is needed."

One of the major cost drivers for those who provide residential aged care is the cost of building or refurbishing existing facilities to meet current service expectations. Modern residential aged care facilities are expensive to build and maintain and providers may not own the freehold to the land, reducing their ability to finance capital investment. Despite this, many providers were in the process of finalising planning for or building of new aged care facilities.

Five most important challenges for aged care organisations in the next three years*

n = 110



*Rating out of five

Similar to others, aged care directors want the government to create stability in the policy and funding environment to enable providers to catch-up with current change and allow them to develop strategies. But they also want simplification in the policy environment, a reduction in reporting burden and streamlined accreditation standards. In particular, they want standards that reflect the quality of life of aged people, not "44 measures that don't mean anything at all." They also believe that the government should be supporting the provision of low cost finance to enable further investment in infrastructure to meet growing demand.

Directors also spoke of a desire for the Commonwealth government to change its attitude to the sector and to stop treating it as a problem that needs to be solved. Instead they want recognition that, for the most part, Australia has world class aged care services, most of which are provided by NFPs with significant experience and the capacity to offer more with the right support. They believe the future of aged care services will be driven by the effectiveness of government policy in regard to setting more realistic expectations about entitlements, superannuation policies that result in a higher proportion of people having sufficient resources from retirement to death, and investment in an 'ageing well' program and preventative health.

"We are moving towards more user pays and while this presents opportunities for provider, it also presents serious challenges for the care of those without significant means. In moral terms, to what extent can government expect aged care providers to 'balance the social ledger'?"

The Commonwealth government regulates and provides most of the funding for aged care services in Australia. In 2012-13, the Commonwealth spent a total of $13.6bn on aged care including $9.4bn on residential services and $3.3bn on community care.

NFPs provide 58 per cent of residential aged care places and for-profit organisations 36 per cent. Governments provide the remainder. Community care services are also provided by a mix of NFP and for-profit providers.

Aged care services include low and high care residential places, and community care services such as home nursing, meals, help with personal care, and help with household maintenance.

Reform of aged care has been progressively introduced over the last two years and will continue to be rolled out until 2016.

8

Directors' contribution is significant

> *"No, I don't claim expenses and this year I have spent a lot of time traveling (interstate) to recruit a new principal. The expenses are in the thousands but I make a donation to the school every year – which is expected – so it doesn't make sense to then claim expenses."*

The average amount of time NFP directors spend working for a single NFP organisation increased from 16 hours per month in 2012 to 20 hours in 2013. This year, the average was again 20 hours per month. This equates to over six working weeks per year or about two and a half full working days.

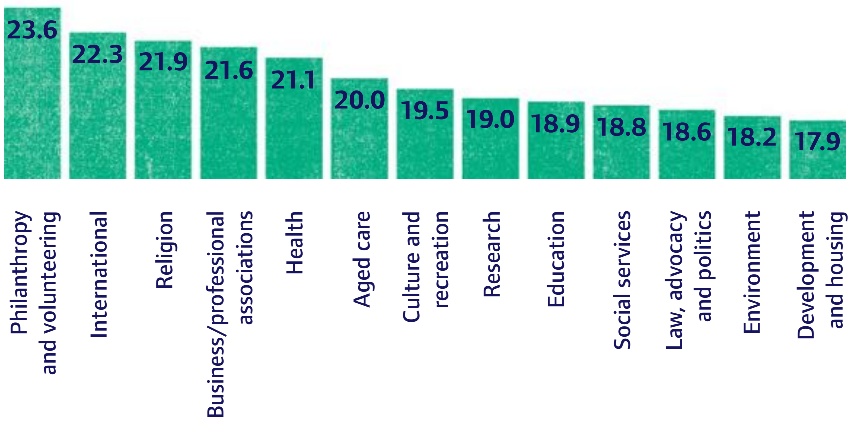
Directors' time contributions vary by size and sector. A quarter of all directors of very large NFPs spend more than five days a month on their directorship duties for a single organisation, compared with only 10 per cent of directors of small NFPs.

In regard to the sector, directors working for NFPs operating in philanthropy and volunteering spent the most time on their directorship duties, averaging 23.6 hours a month on a single NFP. The least amount of time was spent by directors working in economic development and housing, who averaged 17.9 hours per month.

Nearly half of NEDs included in this study work for more than one NFP organisation and, on average, they have 1.6 directorships, which is similar to previous years. Despite no change in the number of directorships they hold, there has again been an increase in the amount of time directors' report spending on all their NFP directorships. In 2012, the average was 23 hours per month; this year it is 32 hours or four days per month[7].

Average hours NEDs spent by sector

n = 2,237



[7] This information is based on reported not recorded hours, and it is possible that the increase partly reflects an increase in awareness of the hours spent.

Payment of directors' fees

The majority of NEDs of NFPs provide their time and expertise for free. This is true even for those who work for our largest NFPs. More than half of our respondents (51 per cent) do not receive fees and pay any expenses they incur as a result of their directorship role. Approximately a quarter have their expenses paid and three per cent receive an honorarium.

This year, 16 per cent of directors reported being paid. Although this appears lower than the 19 per cent in our 2013 study, the result is within error levels and therefore reflects approximately the same ratio.[8]

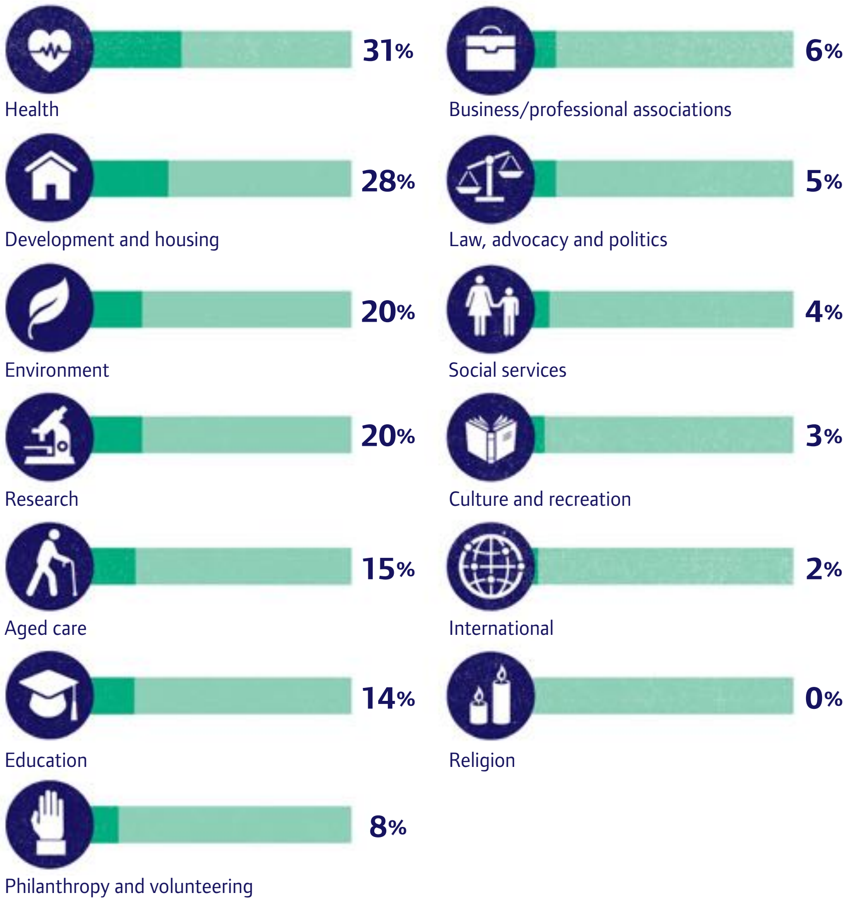
As reported in 2013, payment of directors is correlated with NFP income. Nearly 30 per cent of directors of NFPs with income over $20m per annum are paid, compared with 12 per cent of directors of NFPs with income less than $10m.

Perhaps less expected is the extent to which the payment of directors' fees varies across sectors. This difference is likely to be partly related to the variation in the average income of NFPs operating in different sectors. Nevertheless, it is interesting that 31 per cent of this year's directors working for NFPs in the health sector are paid, as were 28 per cent working in economic development and housing. In contrast, only 12 (four per cent) of the 307 directors working for NFPs in the social services sector received directors' fees, and none of the directors of religious NFPs received payment.

"Payment of directors is only going to happen if we have a major change, like taking over another operation (merging)"

Per cent of directors paid by sector

n = 2,239



[8] This could be the result of sampling not a decline in the percentage of paid directors

"On one hand, directors contributions are significant and they should not be expected to do it for free. But on the other, how much to pay is just fraught with so many problems; it's just easier not to go there."

Directors' fees

Highest: $185,000

Median: $20,000

Highest paid 10 per cent receive more than $60,000

Lowest paid 10 per cent receive less than $6,800

How much are NFP directors paid?

For the first time, the 2014 study asked how much directors were paid in the last financial year and 321 directors provided this information. The amounts received ranged from $1,200 to $185,000.

When ranked in order of amount received, the lowest ten per cent of paid directors received less than $6,800 and the highest ten per cent more than $60,000. The median payment for 2013-14 was $20,000.

Although payment of director fees appears dependent on both income and sector, the history and culture of the organisation are also key determinants.

It is clear that there is no rulebook on this issue and the decision to pay directors is unique to each organisation. In our discussion groups, directors' opinions remain strongly divided and they commented that the question of whether to pay directors cannot be separated from the question of how much. Several remarked that there was no evidence that NFP director performance is correlated with quantum of pay, and therefore the decision on the amount of pay is highly subjective. They also noted that constitutions of NFPs, and the difficulty of changing these, are significant barriers to change. Further, that once done, it was not likely to be reversed, opening the door to possible exploitation or, at least, for on-going disputes between stakeholders. Directors of organisations in competition for government funding, or reliant on donations, believed that payment of directors fees would have a direct and significant negative impact on future income.

We aim to explore these issues in more detail in future studies, with a particular focus on identifying the characteristics of organisations that pay director fees; if they shifted from non-payment and how; and if they noticed an increase in the quality of governance or ability to attract directors.

9

Certainty in government policy is needed

Responding to change and uncertainty in government policy is a top priority

Maintaining or building income, diversifying income sources and clarifying strategy are still key priorities for the next year but many boards now have to meet these challenges in an environment of widespread change in government policy.

The election of the Coalition Federal Government in 2013 brought with it major reforms to education, aged care, disability services, health care and social services, many of which will have a major impact on how NFPs operate, even requiring some to completely redesign their business models. In addition, the NFPs in our survey receive an average of 30 per cent of their income from the Commonwealth and 23 per cent from the state governments, and both tiers have announced significant reductions in government spending.

Many NFPs are struggling to determine the impact of these changes and in several areas policies and legislation are either still being determined or have not been passed by government. This has a significant impact on NFPs' ability to plan for the future, to secure appropriate resources and to maintain the required number and composition of staff. They are caught between needing to respond quickly and effectively to new policy and trading conditions or waiting until changes have been finalised.

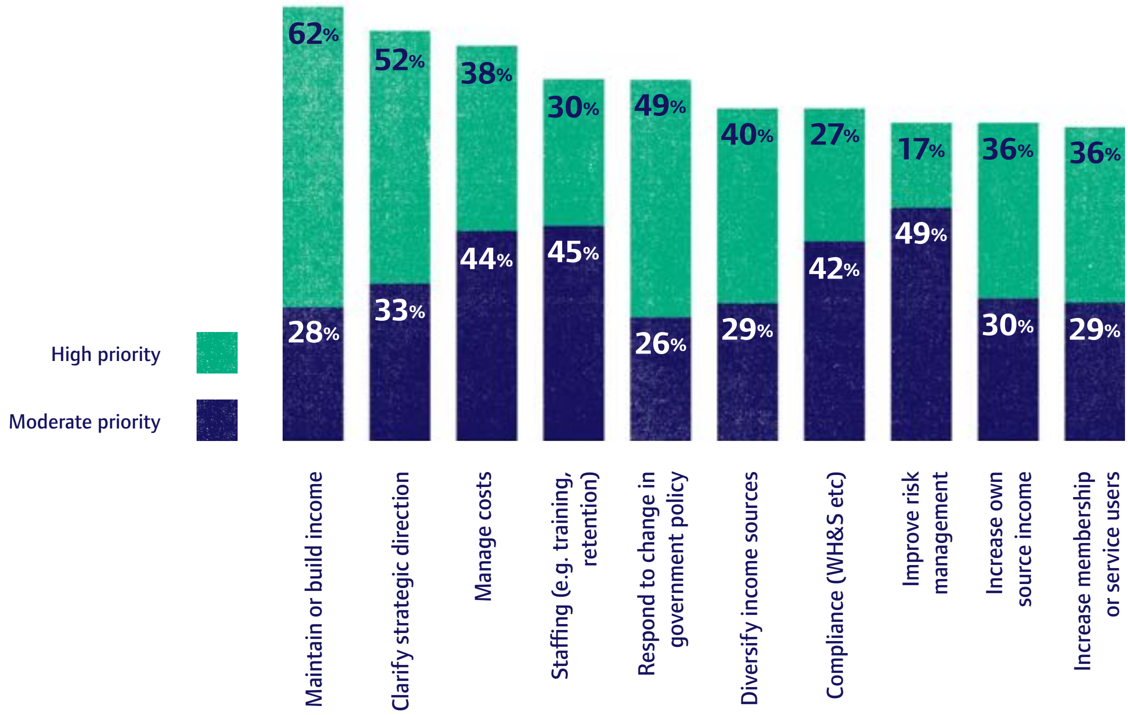
This was a strong theme throughout this year's study.

"Decision-making is frozen. We have no choice but to wait – but there's no certainty that when they change something it will stay changed."

"We can cope. We just need to know what we are coping with."

NFPs' priorities for the next 12 months

n = 2,040



"We are baffled why the ACNC has been dropped. It was working really well for us"

"ACNC reform has provided a raft of very clear guidance and simplified processes"

Directors want the Commonwealth government to keep the Australian Charities and Not-for-profits Commission

There were a significant number of unprompted requests from the sector for the Commonwealth government to retain the Australian Charities and Not-for-profits Commission (ACNC). The questionnaire made no mention of the ACNC yet many written comments strongly supported its retention. For example, 15 per cent of unprompted 'other' responses to the question regarding priorities for government were requests to retain the ACNC.

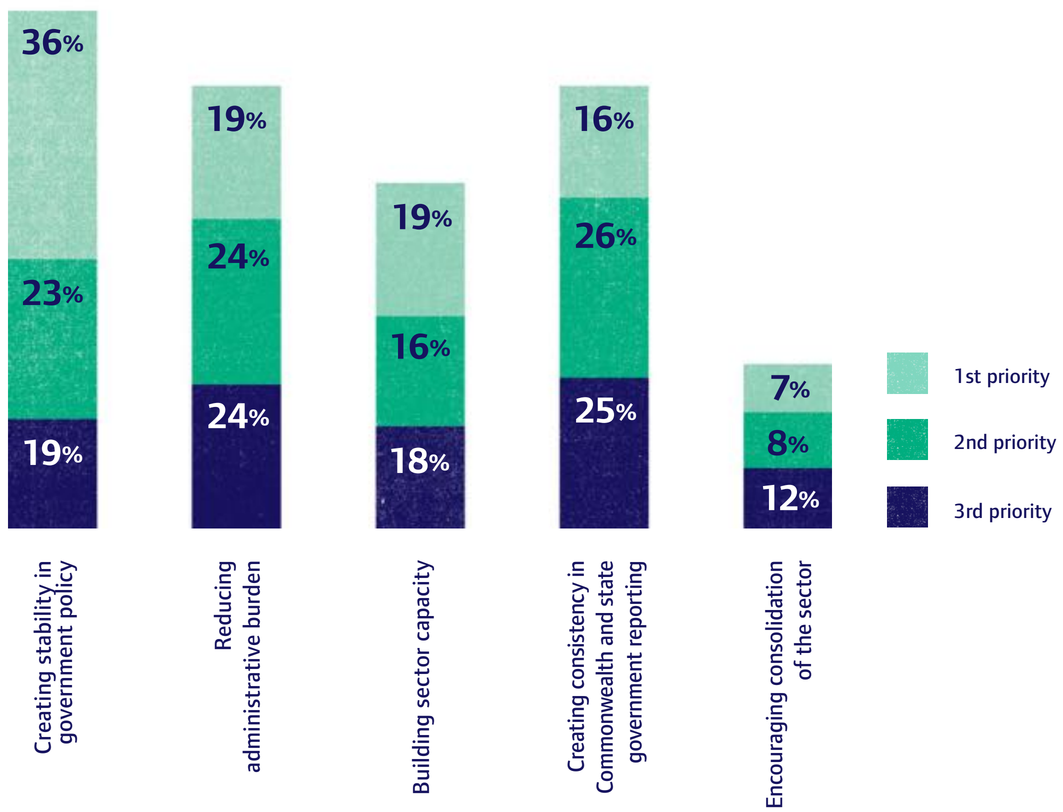
Similarly, the ACNC was not raised by the group moderator but in seven of the eight focus groups directors raised the topic of the future of the ACNC and expressed strong views that it should be retained. They felt that given the years of consultation, the amount invested by government in its establishment and the response from the sector, it should at least be run for three or four years to see if is worthwhile. Further, they said if it is removed without being fully tested, there would be continued debate about what is best for the sector and low acceptance of alternatives.

Directors want government to create clarity and stability

In recent years, reducing the reporting burden has been the key message NFP directors wanted to get through to the Commonwealth government. While this is still important, it is no longer the top priority. Instead 36 per cent are calling for the government to clarify its direction, implement change and create stability in operating environments. This will enable better, longer term decision-making and investment.

Top three priorities for the Commonwealth government for the next three years

n = 1,963



The research method and survey sample

Research method

The study included qualitative and quantitative research undertaken from May to August 2014.

Eight focus group discussions were held with a total of 58 directors from a diverse range of NFP organisations. The groups consisted of between four and nine members and lasted for a minimum of 90 minutes. This year two groups were held in regional centres, one in Bunbury, south of Perth, and a second in Bendigo, north west of Melbourne.

Perth
Group 1: Aged care sector NEDs

Bunbury
Group 2: General NFP NEDs

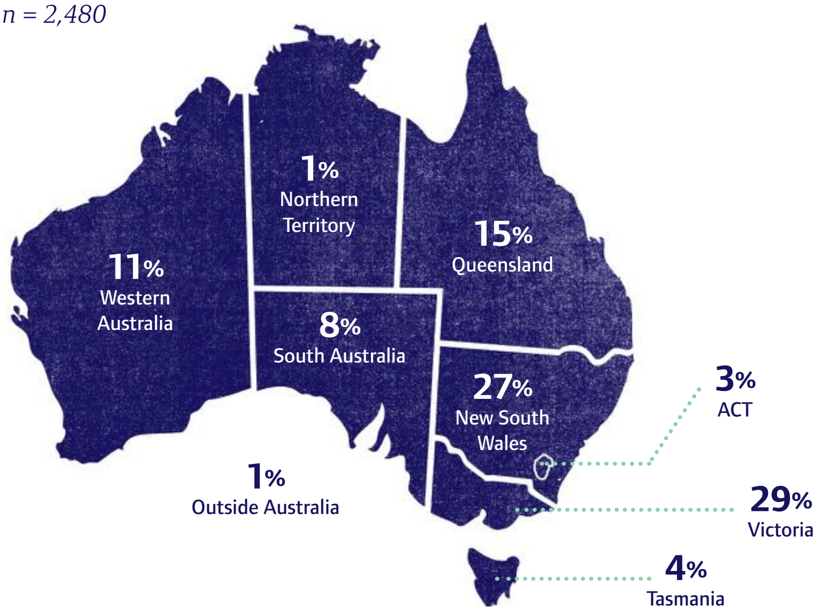
Canberra
Group 3: General NFP executives
Group 4: Education sector NEDs

Melbourne
Group 5: General NFP NEDs
Group 6: Education sector NEDs
Group 7: Aged care sector NEDs

Bendigo
Group 8: General NFP NEDs

Location of survey respondents

n = 2,480



Note: Total does not add to 100 per cent due to rounding

The survey sample

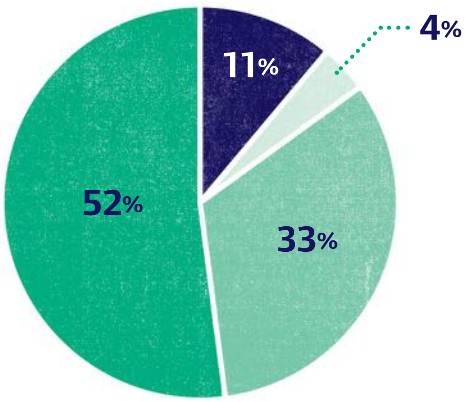
The survey was emailed to 30,572 Company Directors' members and distributed via associated organisations. Our aim is to widen the base of participants and this year four per cent were non-members. We will continue to encourage participation by non-members in future years.

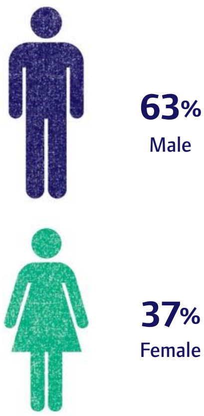
Directors in our sample represent the larger NFP organisations in Australia. Seventy per cent work for NFPs that had income over $1m in 2013-14 and of these, 23 per cent had an income over $20m. Collectively, they represent NFPs with a combined 2013-14 income of over $15bn.

The characteristics of the sample are summarised below. The NFP Governance and Performance Study is based on a self-selected sample and the population included can vary from year to year limiting the capacity to compare the results over time.

Total survey respondents

n = 3,210





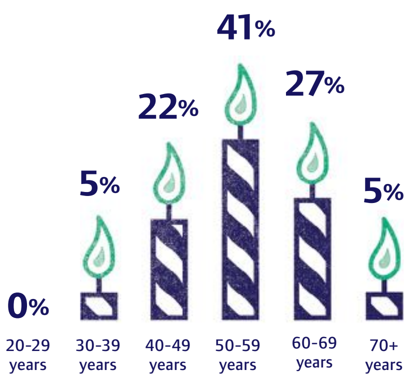
For-profit only
n = 142

NFP and for-profit
n = 1,045

NFP only
n = 1,674

Not currently a director
n = 349

Age of current directors



Average age

Appendix A: Industry codes

The activity categories used in this study are based on the International Classification of Non-profit Organisations (ICNPO)[9] used by the Australian Bureau of Statistics and other statistical bodies. To enable identification of organisations operating in the education sectors, category 2 was divided into Education and Research. Aged care falls into both the Health and Social services categories and could not be easily separated so an additional category was used.

ICNPO Classifications	Level 1	Level 2	2014 Governance and Performance Study Activity Sectors
1	Culture	• Culture and arts • Sports • Other recreation and social clubs	Culture and recreation
2	Education	• Primary and secondary education • Higher education • Other education • Research	Education
			Research
3	Health	• Hospitals and rehabilitation • Nursing homes • Mental health and crisis intervention • Other health services	Health
4	Social Services	• Social services • Emergency and relief • Income support and maintenance	Social services
5	Environment	• Environment • Animal protection	Environment
6	Development	• Economic, social and community development • Housing • Employment and training	Development and housing
7	Legal	• Civic and advocacy organisations • Law and legal services • Political organisations	Law, advocacy and politics
8	Philanthropy	• Grant-making foundations • Other philanthropic intermediaries and voluntarism promotion	Philanthropy and volunteering
9	International	• International activities	International
10	Religion	• Religious congregations and associations	Religion
11	Business	• Business associations • Professional associations • Labour unions	Business and professional associations
12	Not elsewhere classified		Not elsewhere classified
			Aged care

[9] See ABS 5256.0 Australian National Accounts: Non-profit Institutions Satellite Account 2012-13 Appendix 1 ICNPO Classifications. ICNPO Classifications

About us

We are an internationally recognised, member-based, not-for-profit organisation that provides leadership on director issues and promotes excellence in governance.

We have more than 35,000 members, including more than 850 members based offshore, in countries including China, Singapore, Hong Kong, Indonesia, the United States, the United Kingdom and the United Arab Emirates.

Our membership includes directors from organisations as diverse as ASX-listed companies, government bodies, not-for-profit organisations (e.g. charities and arts organisations) and family owned/private companies and entrepreneurial ventures.

Our principal activities include conducting professional development programs and events for boards and directors; producing publications on director and governance issues (including books, *Company Director* and *The Boardroom Report*), and developing and promoting policies on issues of interest to directors.

The Global Network of Director Institutes (GNDI) provides us with a forum to demonstrate the leadership of Australian directors internationally, and to share expertise in corporate governance and professional director development. GNDI is comprised of membership organisations for directors from Australia, the UK, US, Canada, Malaysia, New Zealand, Brazil and South Africa.

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The NFP Governance and Performance Study 2014 was conducted by BaxterLawley on our behalf.

04531-1_14

A strong and sustainable not-for-profit (NFP) sector is important to the Australian economy and community, 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 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 Aged Care and Education.

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.

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