



2016

NFP  
GOVERNANCE AND  
PERFORMANCE  
STUDY

Australia's NFP Sector | Raising the bar

## Commonwealth Bank – Supporting social impact



It is with great pleasure that the Commonwealth Bank's Social Impact Banking team has once again supported the Australian Institute of Company Directors' NFP Performance and Governance Study 2016.

In looking at this year's findings, it remains clear that the range of challenges faced by those working in the Not-for-Profit sector continues to grow. What is also apparent is the resilience of the sector as organisations recognise and adapt to the ever-changing and competitive environment in which they find themselves. For example, we have seen with the beginning of the rollout of the National Disability Scheme (NDIS), many organisations beginning to change their operating models as they transition to new funding arrangements and the need to market their services.

A continuing theme for the Not-for-Profit sector remains around the need to diversify funding in order to achieve financial sustainability. For all organisations – whether in the not-for-profit or for-profit worlds – a strong balance sheet remains vital in order to withstand market ups-and-downs. And yet the ability to build a financial buffer remains problematic.

As this year's report indicates, there is concern among many not-for-profits that holding surplus reserves may result in a reduction in funding with donations directed to those who appear to be in more financial need.

The report also highlights the need to educate stakeholders and the wider Australian population about the necessary structural transition that needs to take place within the sector. This requires the Not-for-Profit sector to gain a greater share of market voice as it leads discussions around the increased use of social enterprise models; strategic approaches to asset management and the need for greater efficiency in government funding.

The 2016 report supports what we, at the Commonwealth Bank, are seeing more often – the need for the Not-for-Profit sector to change and innovate as more community organisations strive to achieve financial sustainability.

We remain committed to the Not-for-Profit sector and working towards enhancing the financial well-being of individuals, businesses and communities. On behalf of the Commonwealth Bank's Social Impact Banking team, we hope you find this year's study of interest, and look forward to working with you in the months and years ahead.

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

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or contact e: [CommBankNot-For-ProfitBankingSector@cba.com.au](mailto:CommBankNot-For-ProfitBankingSector@cba.com.au)  
t: 1300 138 542**

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# Foreword by John Brogden AM FAICD



Welcome to the seventh annual Not-for-Profit (NFP) Governance and Performance Study.

The study remains a cornerstone of our commitment to supporting NFPs to achieve better outcomes through good governance.

The NFP sector is experiencing a period of unprecedented change. In the context of an evolving regulatory landscape, new funding models and an increasingly complex operational environment, good governance has never been more important for NFPs.

In our national reform document, *Governance of the Nation: A Blueprint for Growth*, released earlier this year, we called for a partnership approach between governments and the NFP sector. As part of this work, we are continuing to advocate for improved funding certainty with a best practice model of five-year cycles, 12-month notice periods of funding termination, freedom of voice in public debate, and investment in internal capability.

At the foundation of this call is a challenge to governments and the broader community to re-think their understanding of NFPs, their roles and how they operate. The data in this study highlights that perceptions of the sector must adapt to reflect the reality of NFPs in 2016.

That's why in this year's study, we have highlighted that NFPs must be financially strong. This means that an NFP must make a profit which can be re-invested into the organisation so that it can continue to achieve its outcomes.

The results of the study show that many NFPs do not have a clear understanding of the importance of profit and low expectations of financial performance could be undermining long-term financial sustainability. The study

also highlighted that while most NFP directors recognise the importance of strategy, changes in their operational environment are drawing their attention towards more short-term or operational matters.

In addition to the themes of financial strength and the sector's relationship with government, the study also delves into the role of strategy, collaboration and performance measurement.

This year's study again comprised an online survey and several focus groups held in Perth, Darwin, Brisbane, Toowoomba, the Sunshine Coast and Sydney. The respondents reflected the diversity of Australia's NFP sector and we thank all of those who participated in the study.

This year we have included some questions that directors and stakeholders may wish to ponder as individuals, but also to incite meaningful conversations about the findings of the study among NFP boards around Australia.

We trust that you find the study insightful and helpful.

A handwritten signature in blue ink, appearing to read 'John Brogden'. The signature is stylized with large, sweeping loops and is positioned above the printed name and title.

**John Brogden AM FAICD**

Chief Executive Officer & Managing Director  
Australian Institute of Company Directors

# Challenging expectations about the sector

The NFP sector is well-governed, achieves outstanding results, and has continued to evolve over its 200 year history. It remains an essential component of Australia's community infrastructure and a leading contributor to the economy.

It was once commonly held that governance of NFPs was generally poor compared with the for-profit sector, but side-by-side testing has repeatedly shown that this is not the case. In fact, some see NFP governance as more complex due to the need to achieve both mission success and financial strength, and the complex environments in which NFPs often operate.

Many NFP organisations have actively invested in improving governance in response to growing awareness of the role of boards, external pressure from funding and regulatory bodies, and support from professional organisations, including the Australian Institute of Company Directors.

However, there are some areas in which progress can still be made. Directors consistently raise concerns about financial sustainability, performance measurement and relationships with government. Many of these challenges are seen as insurmountable.

The AICD has been undertaking research into NFP governance and performance for over seven years.

In this time we have tested long-held assumptions, examined claims about performance, and challenged directors to tell us about their concerns and opportunities – not just about what is happening, but why, and what directors and boards can do to respond.

The data gathered has been presented in seven editions of the annual NFP Governance and Performance Study. Over the years, this study has provided valuable information on the sector and, among other things, has shown that the standard of NFP governance is good but highly variable, just as in the for-profit sector.

To encourage more thoughtful conversation and to support the identification of solutions, this year we have focused on examining the differences between NFPs that are high performing and those that are not. This report reveals that NFP boards can grow their impact by challenging their expectations, setting higher goals and improving their long-term strategic planning.

It also shows that governments and the community need to shift their thinking about the NFP sector.

Governments and the broader community must recognise that 21st century NFPs are often highly sophisticated, efficient and well-governed organisations.

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It's time for a more mature approach to working  
with the sector.

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# 1.

## NFPs must *aim* to be financially strong

Many NFP directors perceive that their organisation and others in the sector operate in a constant state of financial stress. Achieving financial sustainability, diversifying income sources and managing expenses are consistently reported as challenges for the sector. Yet over the years, our research has found that despite this, some NFPs are not only surviving – they are thriving. They are achieving their mission and creating organisations that are financially strong in doing so.

What sets organisations that flourish apart from those that struggle? The results from this year's study reveal that **NFP financial performance depends not only on size and operational environment, but also on directors' and CEOs' expectations of performance and their motivation and ability to deliver it.**

This year we've compared financially successful organisations with those experiencing (or appearing to experience) difficulty to encourage all directors to reflect on their own NFP's performance and what they can do to raise the bar.

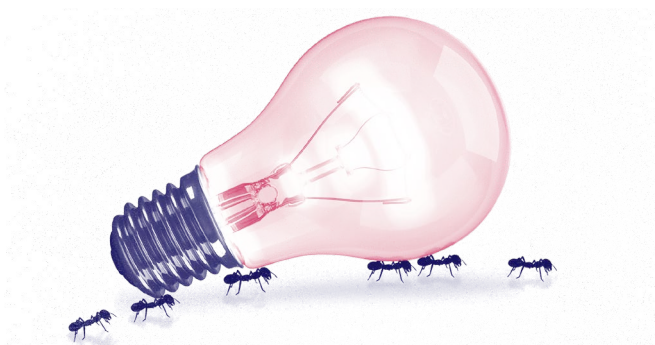
### Challenging perceptions of profit

Our research found that there is considerable misunderstanding about profit in an NFP context. Indeed, many directors reported that they found the term 'profit' uncomfortable and preferred to use the word 'surplus'. This misunderstanding makes it challenging to develop a mature and sophisticated outlook on financial performance.

*“If we made a profit, we would have to give the money back.”*

NFPs can and do make profits, but the profit is retained by the organisation and applied to achieving its mission rather than distributed to individuals for their private benefit. In some sectors, such as childcare, NFPs are able to, and do make significant profits, sometimes exceeding 25 per cent.

*“It is my understanding that it's illegal to make a profit.”*



## How much profit should NFPs make?

The appropriate level of profit can be difficult for a board to determine, particularly in fields such as human services where making a profit to enable long-term survival may mean beneficiaries miss out on services in the short-term.

The appropriate level of profit depends on a number of factors such as stage of development, operating environment and goals. NFPs working in complex and uncertain environments will require more profit to offset risk, as will those with ambition to grow. Others, such as those in high-margin sectors, will maximise profit while they can, in order to build their assets and enhance long-term sustainability. Still, there are some NFPs for whom profit is not a priority, and this is unlikely to change.

In the life of an NFP, there will be times when things are good, times of stability, and for some, the time may come when it is best to wind up. NFPs can survive a loss in a single year, or even for a few years, but unless they have a reliable benefactor, over the long-term they must make a profit to survive.

For the first time we now have data on how much profit (or loss) NFPs are making. As expected, there is considerable variance across the sector:

About two-thirds of directors (64 per cent) reported that, on average, their organisation made a profit in the last three years, one in five (20 per cent) reported breaking even and 14 per cent reported making a loss.

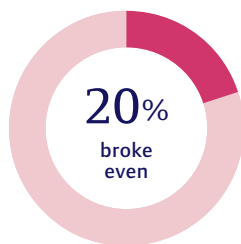
The outlook for the current financial year is less positive: more than half (59 per cent) of surveyed directors reported their organisation will make a profit, a quarter will break even and 17 per cent expect to make a loss.

Of the 64 per cent of directors that reported making a profit, a quarter reported profits of less than three per cent, an amount that would barely cover inflation.

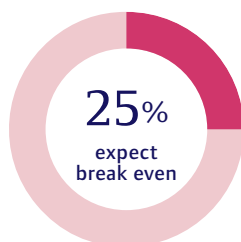
*“We are sitting on a lot of assets that could be used better.”*

## Are NFPs making enough profit? (n=1,403)

### Last three years

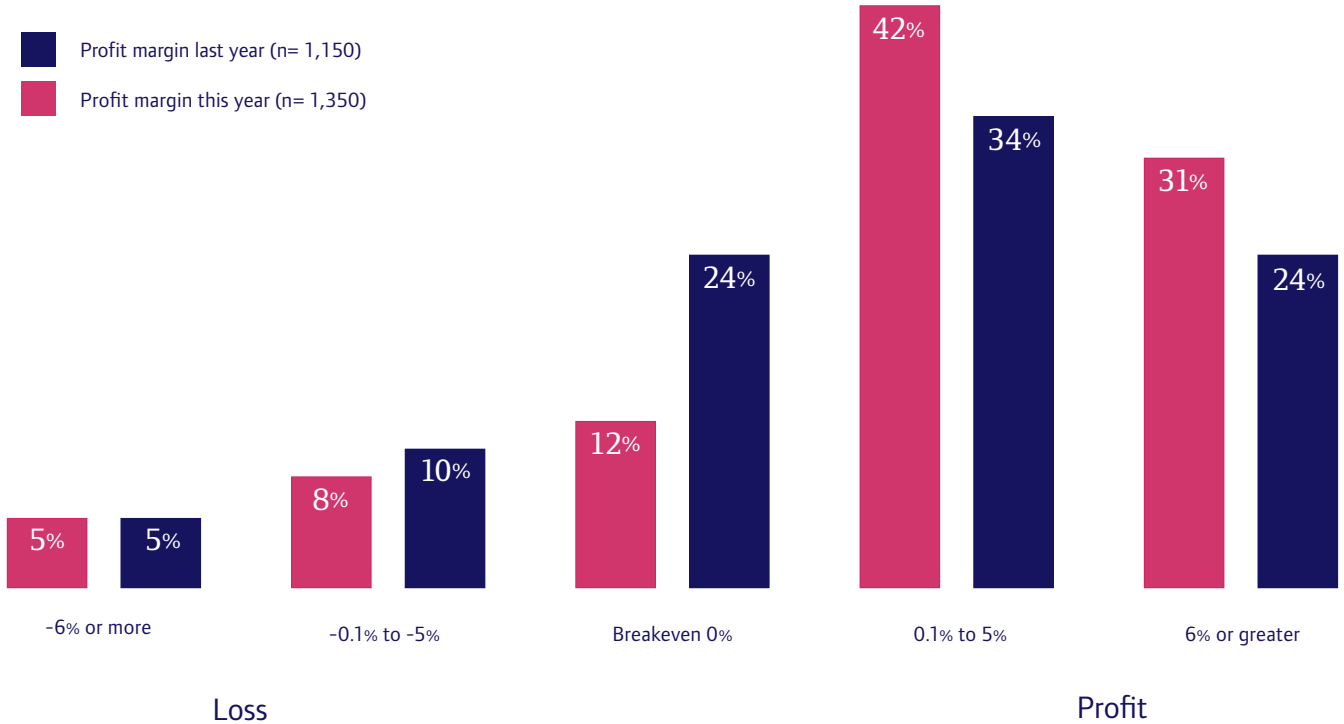


### Next three years



What this data indicates is that although some NFPs are making a profit, the profit is often insufficient for long-term survival. If the trend continues, some organisations (at least a third) may soon be in financial distress. If profit does not exceed inflation, an organisation is effectively making a loss and will need to draw down on assets to continue to operate in the longer term. On the other hand, a quarter of the directors whose organisations made a profit said that they had a 20 per cent margin, indicating significant variability in profits and expectations across the sector.

### Profit margin



### NFPs should aim to have strong balance sheets

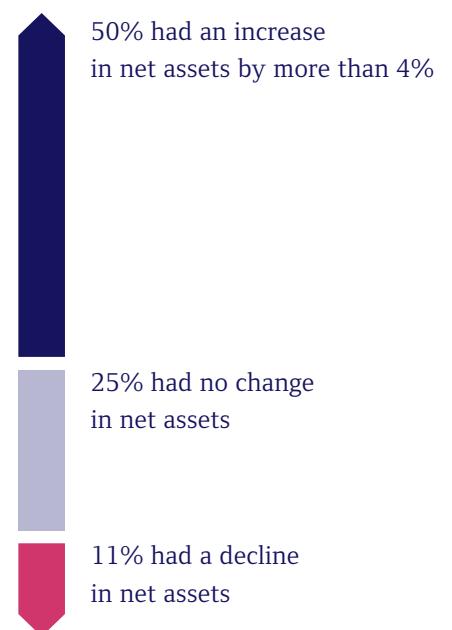
A strong balance sheet is essential for financial sustainability and changes in net assets are a key indicator of financial performance.

Just over one in ten directors report their organisation had a reduction in net assets, while a quarter had no change. A further 12 per cent reported an increase in net assets of between one per cent and three per cent, indicating growth at or below inflation.

At the same time, half of all respondents reported that, on average, net assets had increased by more than four per cent per year over the last three years, with a third reporting net assets had increased by more than 10 per cent. This data lines up with directors' expectations on profit.

There is a clear correlation between growth in net assets and the amount of profit directors expect their NFP will make. Of directors who said their organisation had increased net assets over the last three years, 70 per cent expected to make a profit. By comparison, only 29 per cent of directors whose NFP had a decrease in net assets were expecting a profit.

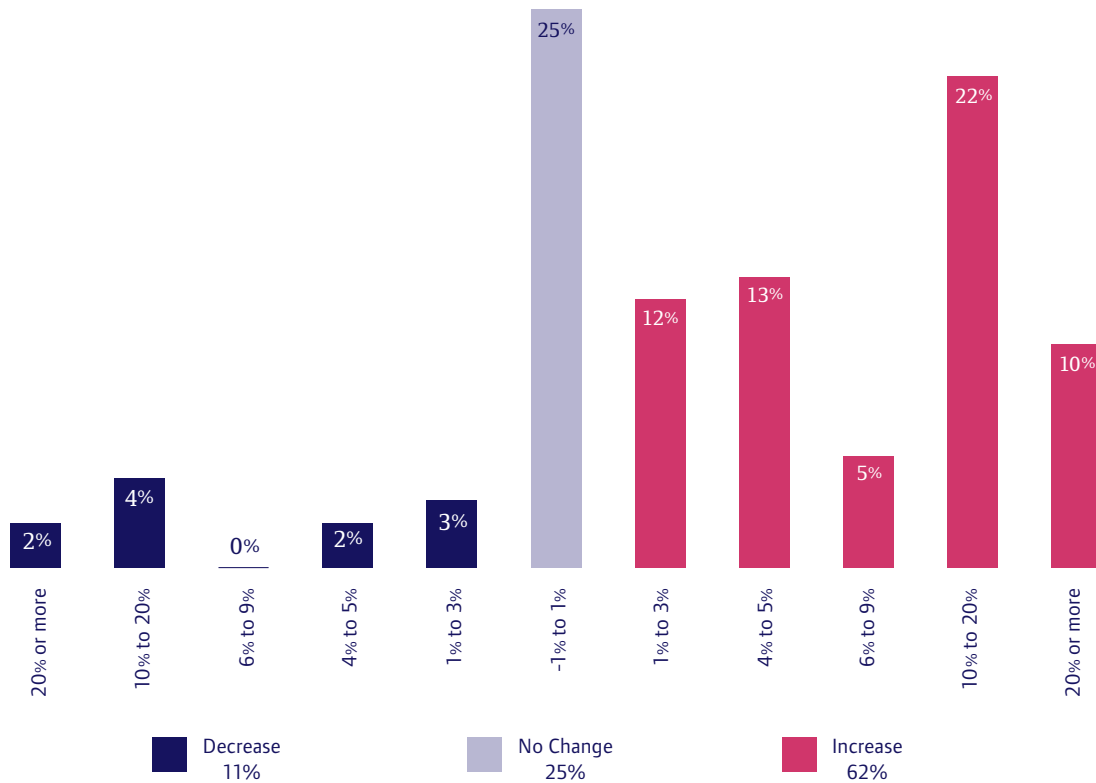
### Annual change in net assets





## Average annual changes in net assets over the last three years

n = 1,350



## Profit is essential for long-term sustainability

To gauge differences in performance expectations, we asked respondents what they felt was an ‘appropriate’ profit margin. This question was carefully worded to encourage judgement about what should be considered reasonable, rather than what has been achieved or would be ideal.

**Over a quarter of directors believe their NFP should make a profit of three per cent or less - which in real terms means no growth.**

Even with encouragement to think about what is ‘appropriate’, 14 per cent of directors believe that zero to one per cent (breakeven) is the right profit target and a further 14 per cent suggested that a profit of one to three per cent is appropriate - an amount that would only keep pace with inflation.

Directors commented that they felt making significant profit or being seen to be ‘too successful’ would not be a ‘good look’ in front of funders or donors. The expected result would be reductions to funding or donations as a result of not appearing to be sufficiently ‘in need’.

A quarter of directors (27 per cent) think their organisation should aim for either four or five per cent profit, which for many organisations would be enough to survive in the long-term.

Some directors, of organisations of all sizes and sectors, have higher expectations – over a third reported that 10 per cent or more profit would be appropriate. Not all of them were necessarily achieving this profit level, but these directors believe that strong profits are an appropriate goal for NFPs.

### Do NFPs have the appropriate risk appetite?

Some directors reported their boards take a 'no risk' approach to investment because they believe it is safer to do little or nothing than to actively manage the organisation's resources. More active asset management would attract stakeholder attention, which would be undesirable.

It would appear that in some cases, directors do not have the understanding or knowledge required to oversee investments or to define asset strategies. Others will simply have an extremely conservative approach. They therefore err on the side of caution or in some cases inaction.

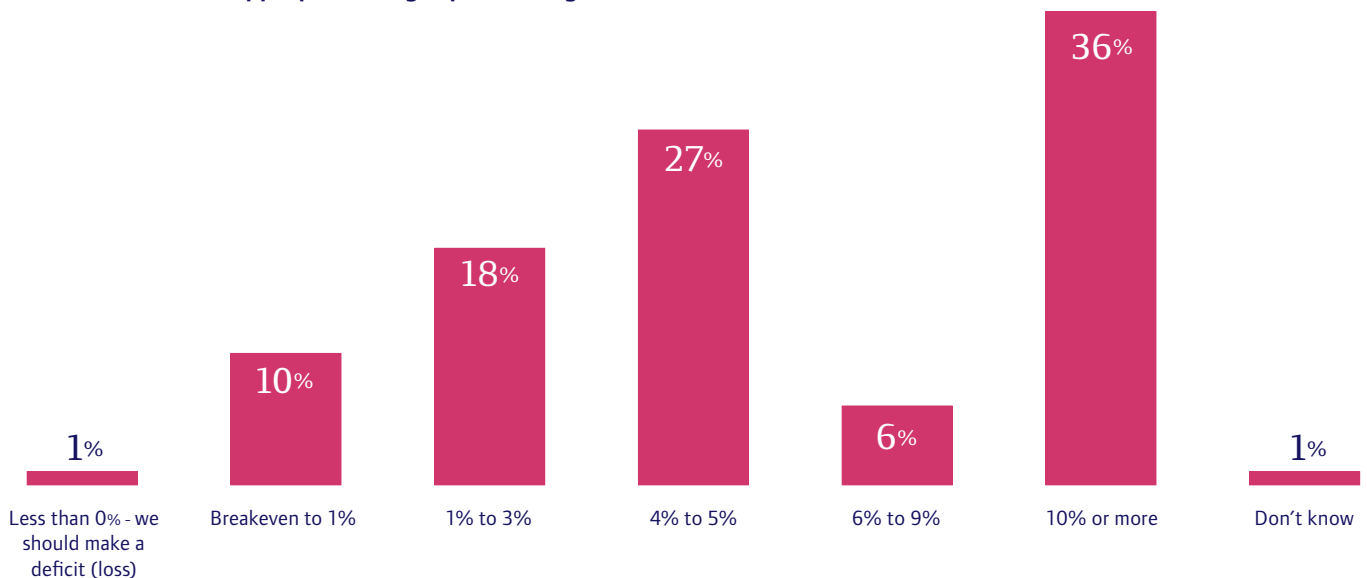
In contrast, the more active boards see themselves as stewards of their NFP's assets. They felt a responsibility to ensure they not only leverage existing resources, but also build resources for the future of the organisation, recognising the need to realise a good return on assets. This involves them taking a balanced approach to portfolio risk by investing in resources that support the organisation to achieve its mission in the longer term. For example, for some NFPs, property is a key resource for service delivery and it appears that some are capitalising on the current low interest rate environment to buy property.

*"In the for-profit environment, you're in trouble if you don't make money. With NFPs, you just have to not lose money. So we are much more conservative than perhaps we should be."*

However, even these more proactive directors and boards showed a propensity to favour low-risk investment strategies and to factor ethical issues into their financial management decisions. These directors reported being more cautious when considering investments for NFPs than they are, or would be, in a for-profit context. Some believed that the NFP environment enabled them to 'relax a little' and to think about more ethical forms of investing which they could not justify in a for-profit environment.

The results from the survey support the focus group findings. Less than half of directors believe their NFP would consider borrowing money from banks or other lenders to buy assets, while 62 per cent would only invest in very low-risk investments.

### What would be an appropriate target profit margin for this NFP? (n = 1,430)



### Conflicting perceptions of financial strength

Both the survey and focus groups revealed an inconsistency between what directors think should be happening and the reality of their organisation’s situation. They felt their organisations should and could achieve greater financial strength, but for various reasons it was not happening.

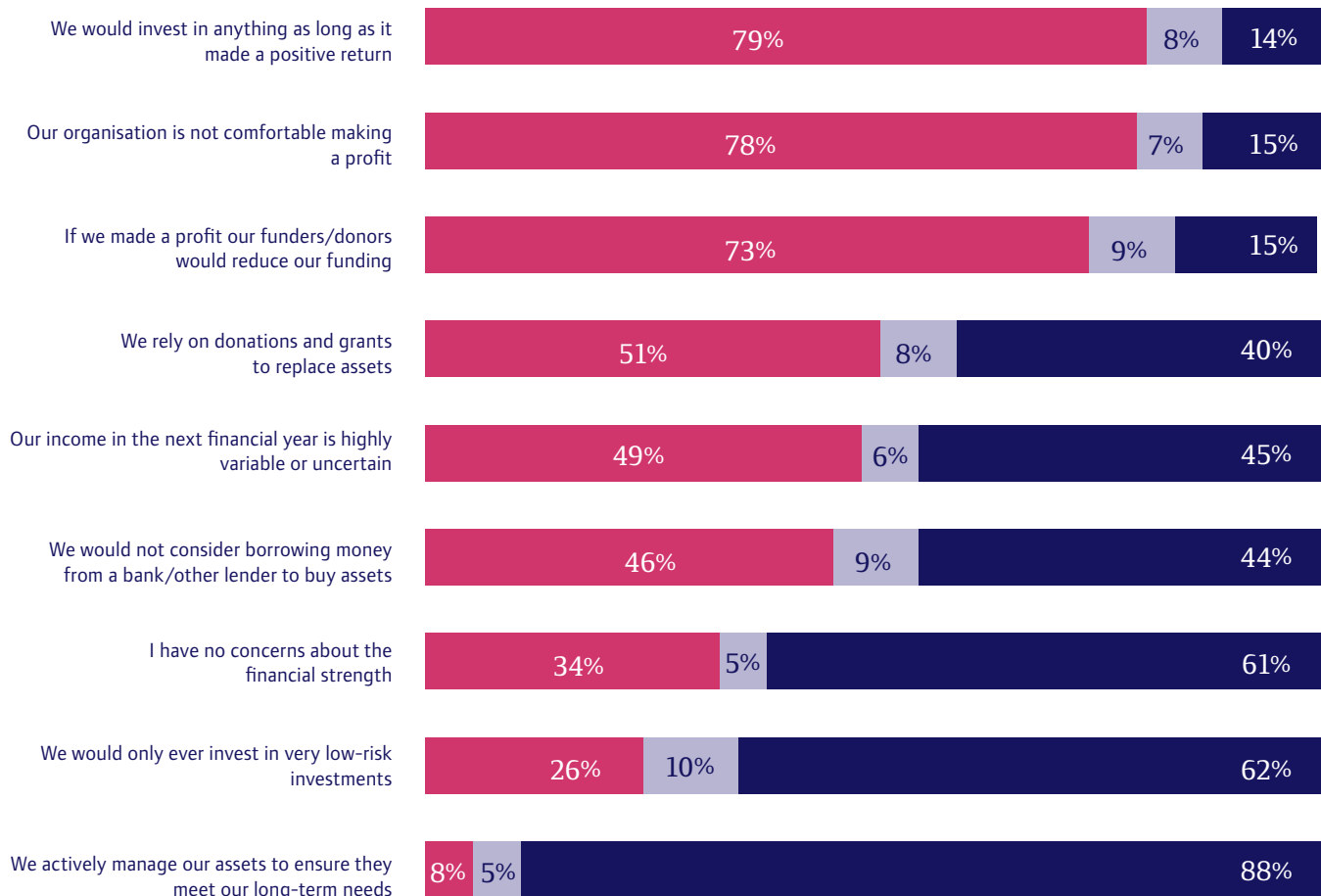
For example, 34 per cent of directors are **not concerned** about the financial strength of their NFP, yet 45 per cent stated that their **income in the next financial year is**

**highly variable** or uncertain. This suggests that more directors should be concerned about financial strength.

Nine out of ten directors say they are actively managing assets to ensure that they meet the long-term needs of the organisation. At the same time, **half say they rely on donations to replace assets**, which is a strong indicator of an organisation that is not sustainable on its own and not managing asset replacement strategically.

### Opinions on financial issues (n = 1,508+)

Disagree Neither Agree



Have you compared your profit margin with other similar organisations?

Is your attitude towards investment risk appropriate?  
Is it defined and understood by all board members?

Is your profit target realistic and appropriate to support your organisation's short, medium and long-term needs?

## Questions for directors and boards

Are you actively building a financially strong organisation, or are you expecting to struggle?

Are you leveraging your assets to best meet your mission, or are they sitting idle?  
What is your target for return on assets?

Do you have enough reserves to invest in efficiency improvement and innovation?  
If not, how will you raise funds?

## 2.

# Strategy is critical for success

Although most directors recognise the importance of strategy, many reported that they focused too much on short-term or operational issues.

The most effective boards control their organisation's future through appropriate strategic planning.

Directors and CEOs have been telling us for several years that their highest priority is adjusting to changes in their operating environment, diversifying income sources and developing and implementing strategic plans.

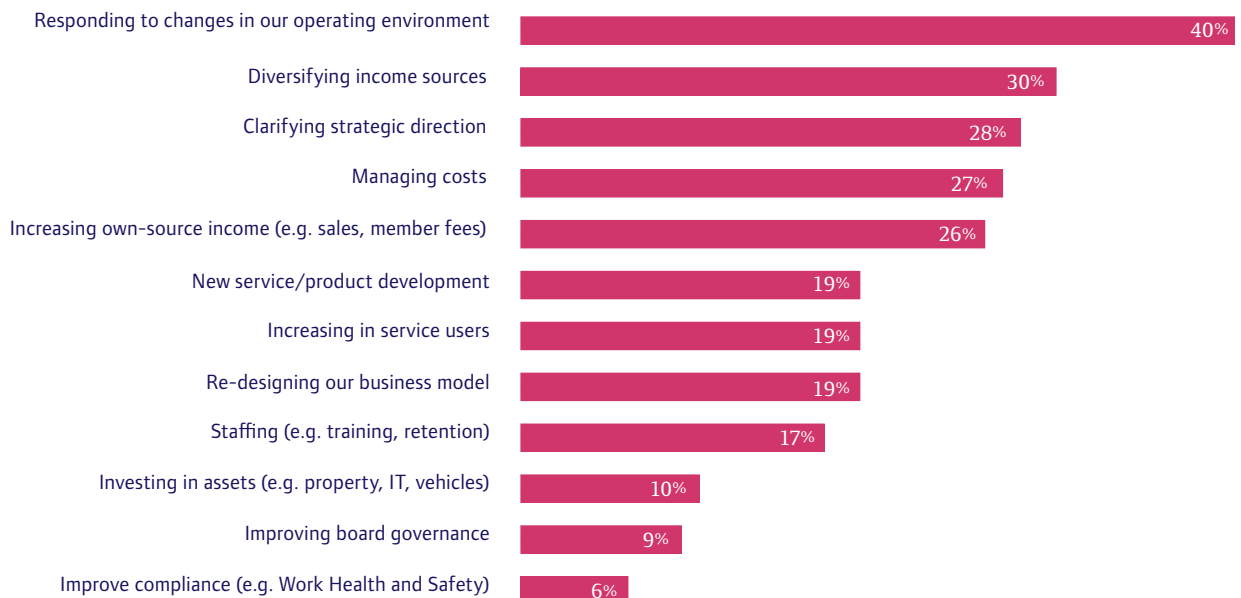
Yet of the things that boards still need to do better, a third mentioned that they either should be better at strategic planning or the implementation of strategic plans, in many cases both. This seems to be a weakness of many

boards and directors also mention the need to think much longer-term, develop clear strategies and build resilience in their organisations.

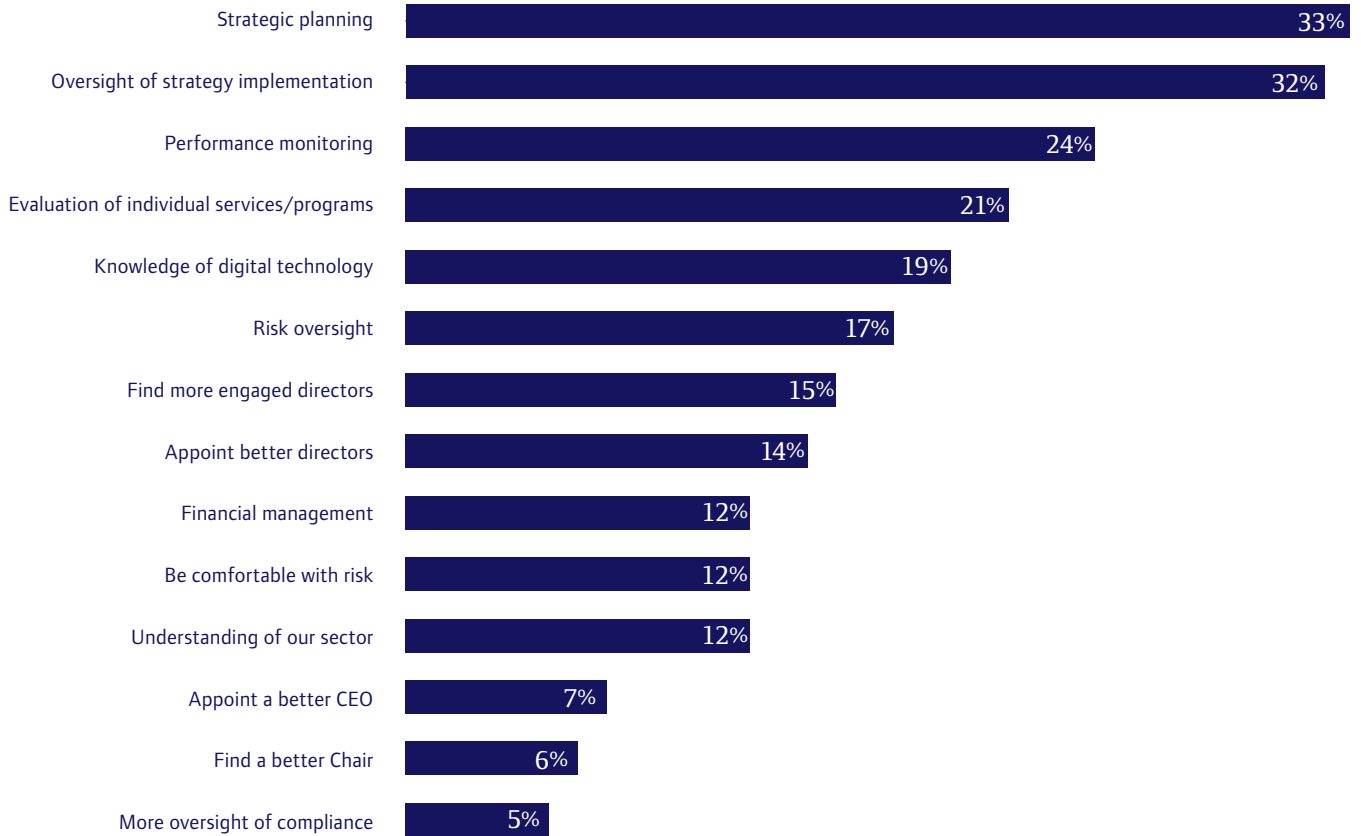
### Effective boards focus on what they can control

Boards with low expectations of profit and financial sustainability tended to have more of an external locus of control, meaning they felt their organisation's future was dependent on factors outside their control. Such factors include the policies and procurement practices of government and changes in the operational environment. These conditions constrain a board's ability to focus strategically.

### Highest priority in the next 12 months (n = 1,178)



### Top three things we could do better to have the most impact (n = 1,120)



### Strategic planning ability needed at the board table

Many respondents consider that a lack of skills and experience available to boards represents a challenge for the NFP sector.

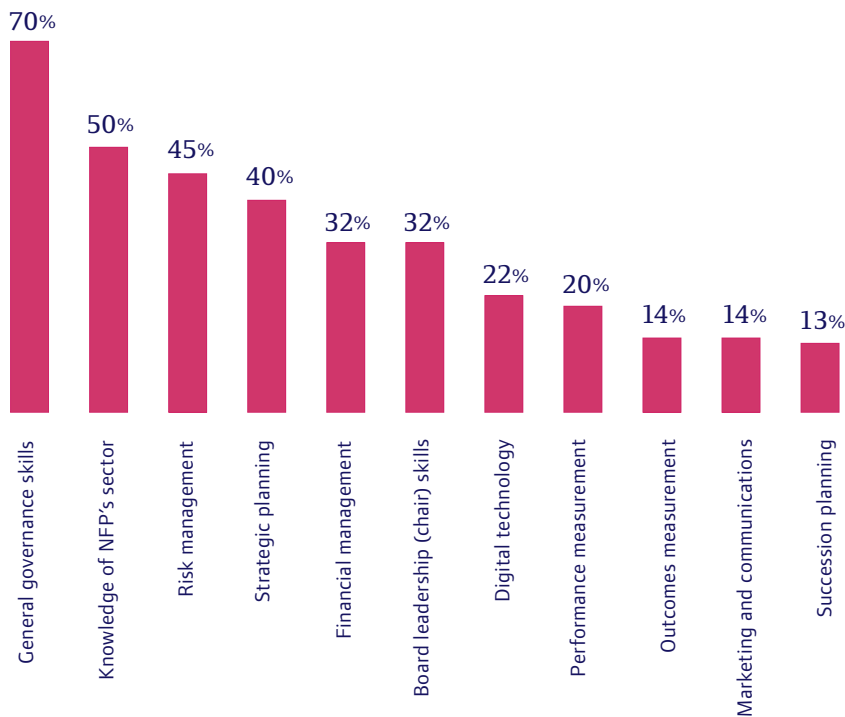
An impressive 90 per cent of directors report they have undertaken some form of formal or self-directed training in the last year. Most (70 per cent) received general governance training, 50 per cent training specific to their NFP's sector and 45 per cent undertook risk management training.

But only 40 per cent of directors received training in strategic planning, 20 per cent in performance measurement and 14 per cent in outcomes measurement.

These results suggest boards and directors should be taking a more targeted approach to skills development. Many could supplement governance and industry training with instruction in strategic planning and implementation, as well as performance evaluation and monitoring.

It is important directors take personal responsibility for raising the standard of their board's skills by extending their own abilities rather than bringing in new directors to fill these gaps.

### What kinds of training or skills development have you undertaken in the last year (n = 1,033)



### Taking back control

In addition to some directors having a belief that their destiny was out of their own control, others mentioned that an oversupply of NFPs prevented more efficient distribution of resources and reflected that some NFPs (though not their own) should consider a merger.

Attributing responsibility for the survival of an organisation to external factors suggests a

sense of disengagement and disempowerment between the board and CEO. This view can result in a culture in which an NFP's directors, staff and volunteers lose their sense of control.

In many industry sectors such as disability and aged care, changes in government policy and in the operating environment are creating challenges for organisations in

### From surviving to thriving

Many of the directors in our study described their NFP and board as having a culture of 'survival'. They believed struggling was normal and to be expected. These boards had low expectations of their organisation, of their sector and of themselves. Some did not set an annual profit target, but instead assumed that their only goal is to break even.

These organisations expect and rely on grants and donations to keep their NFP alive. Because of their 'hand-to-mouth' existence, planning is often short-term and risk averse.

Other directors described their boards as having specific short-, medium- and long-term goals for both mission and financial performance with well-structured strategic plans to achieve them.

These boards were more able to attract and retain directors and senior staff with the skills needed to drive their organisation towards success. These characteristics were consistent across high-performing NFPs.

achieving their aims. There is an ongoing need for NFP leaders to lobby for policies that support the sector.

More proactive boards keep themselves informed of changes and advocate for effective policy. At the same time, they focus on what they can control, and what they should control, in response to changes in the operating environment.

## Strategy

Do we have a clearly articulated strategic plan? Are our activities in line with it? How do we know that is the case?

Does the board understand its operational context? Does it know how it will change in the next five years?

What are the major threats and opportunities our organisation faces? Do we have a plan to address them?

## Questions for directors and boards

## Skills

What skills does your organisation need now and for the next five years? Why?

If my skills are out-of-date or duplicated on the board, should I step down to allow someone with better skills to join?

What responsibility do I have to bring the right skills to the board?

What skills will the board need to best support this organisation? Do we have a skills matrix? If so, is it fully consistent with the organisation's needs based on its strategy?

Do I need to build my own skills and abilities? In which areas?



### 3.

## Collaboration is key, and it's growing

### NFPs continue to collaborate

One of the key strengths of NFPs is their capacity to work together to achieve outcomes.

In times of emergency, NFPs will collectively harness the resources, goodwill and support of entire communities to support those in need. On a day-to-day basis, they collaborate to provide services and reduce costs.

Seventy per cent of directors report that their NFP collaborates with others to advocate for the sector or beneficiaries. Forty-three per cent subcontract the provision of some services to other NFPs, 39 per cent have agreements or memoranda of understanding to refer or service clients, 26 per cent share resources and 15 per cent share back office functions.

In addition, nearly all directors are expecting to increase the extent to which they collaborate in the next year. Three quarters are expecting to increase collaborations for advocacy, more than half will be signing formal agreements with other NFPs to deliver services, a third will increase resource sharing arrangements and subcontracting for the provision of services, and a quarter expect to increase group purchasing arrangements.



70%

collaborate to  
advocate



43%

subcontract  
some services



39%

have agreements  
or memoranda



26%

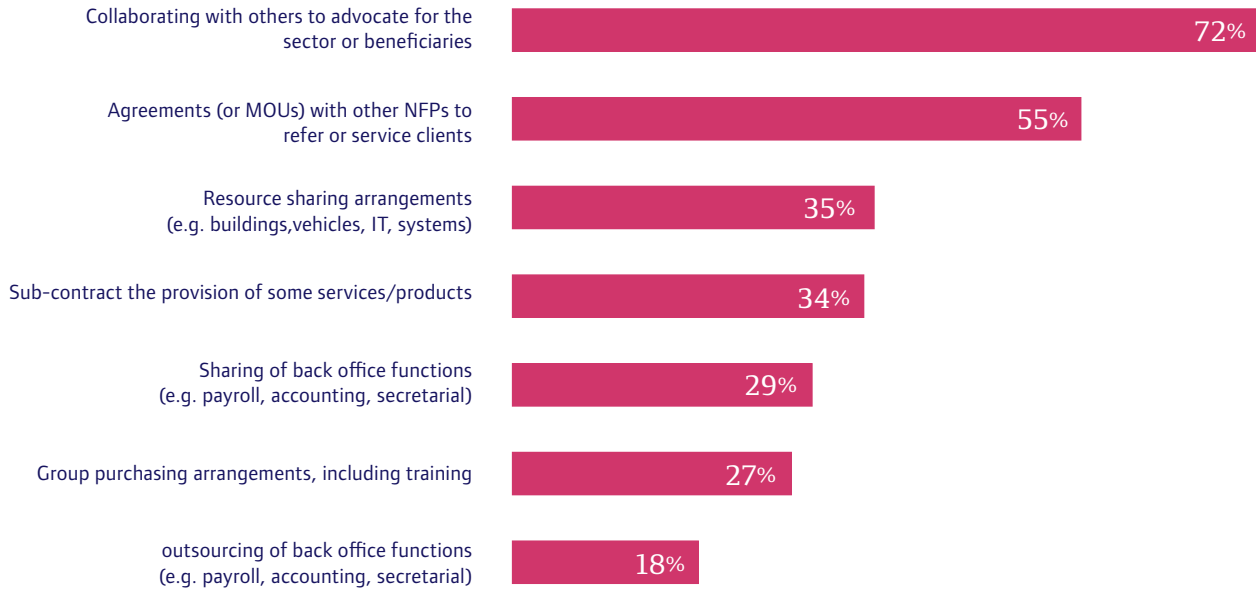
share  
resources



15%

share back  
office functions

### Types of collaboration planned in the next year (n=1149)



### Mergers have remained constant

Rates of mergers have not changed over the past year. As we found in 2015, just over a third of directors (35 per cent) reported that their organisation had discussed a merger in the last 12 months, eight per cent that their organisation is currently undertaking a merger and six per cent that it had completed a merger in the last year.

The reasons for merging or considering a merger are also similar to previous years. The most common reasons directors gave for their NFP merger activity were better meeting their mission, growing or maintaining market

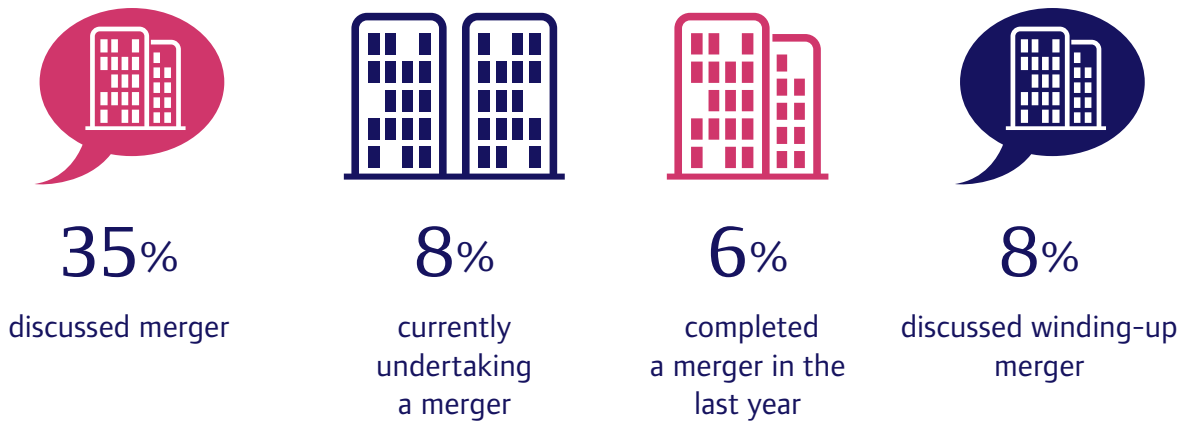
share and broadening the range of their services for users. Eight per cent said they are considering a merger because they are not financially sustainable. In their comments, many directors mention that the merger activity is occurring because another NFP, which is not financially sustainable on its own, approached them.

Of the more than 400 directors who said their organisation had discussed a merger, a third consider it likely or very likely that they will merge in the next two years, while a further 20 per cent said that it is 'somewhat likely'<sup>1</sup>.

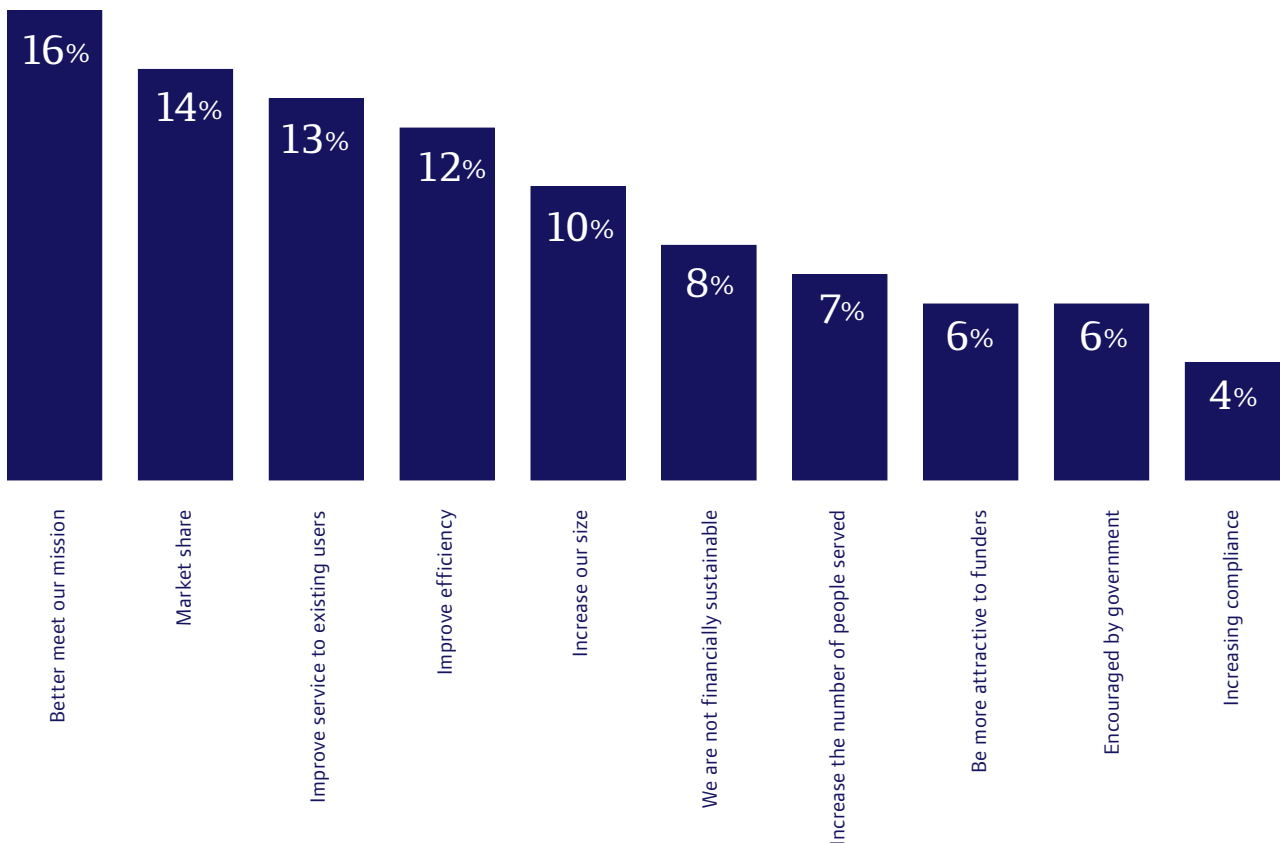
Collectively, these results paint a picture of a sector that is responsive to market forces, contradicting the commentary across the sector in the last five to ten years.

<sup>1</sup> This data includes double counting - e.g. an organisation may have both completed a merger and discussed additional mergers.

Directors whose NFPs have merged, are planning to merge or wind-up (n=1,140)



Reasons for merger (n=488)



## 4.

# Performance measurement is gaining momentum

With the rapid improvement in digital technology, it is now possible to collect, interpret and analyse performance in ways that could previously only be imagined.

Developments in performance measurement are driving expectations from a range of stakeholders. It is also fuelling innovative ways to provide and fund services, including collaborative delivery, outcomes-based contracting and social impact bonds.

Performance data is becoming a key strategic asset and our research shows directors feel they are making real progress in adopting performance measures. An overwhelming majority of organisations use one or more methods to measure performance in some way.

But most also consider there is much more work to be done in the area. Industry commentators report that we are only at the beginning of the digital age. Emergent technology will enable greater capture and more detailed analysis of data. This means that regardless of achievements to date, boards must be prepared for continued rapid evolution in the field of performance measurement.

### How are organisations measuring effectiveness?

We asked directors about the types of information they rely on to measure the organisation's effectiveness.

Over 90 per cent said they were using at least one method. Seventy per cent reported that they assess whether the organisation has achieved its strategic goals, 66 per cent measure performance against specified key performance indicators (KPIs), nearly half use customer surveys and 43 per cent use customer numbers. A third of directors reported that their organisations have to meet external quality standards and measure performance against these.

Approximately a quarter of directors assess performance based on increases in income, either through fees or donations while only 12 per cent use growth in profits as an indicator of performance, which is interesting given the discussion of financial performance in chapter one.

In addition to this data, we also received more than 200 comments on performance measurement, most describing it as a 'work in progress'.



70%

assess whether the organisation has achieved its strategic goals



66%

measure performance against specified Key Performance Indicators (KPIs)



49%

nearly half use customer surveys



43%

use customer numbers



33%

have to meet external quality standards



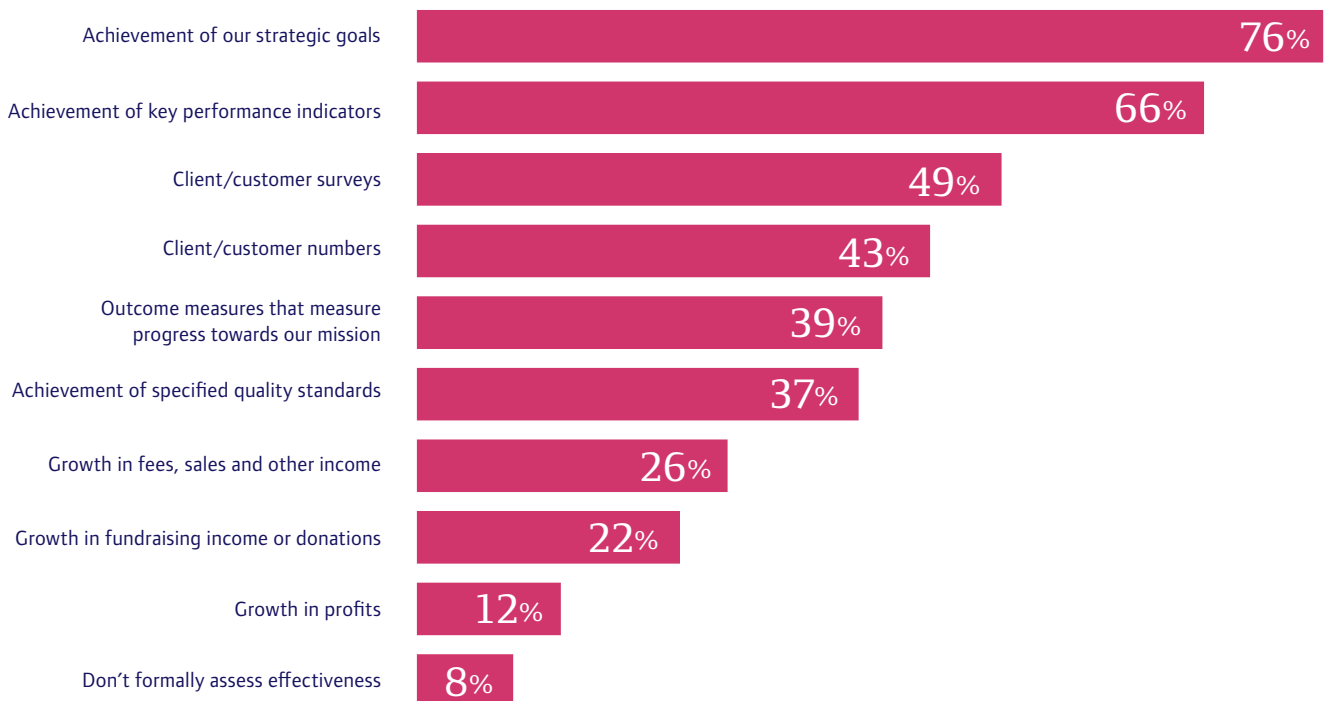
12%

growth in profits

*“The board is currently working on outcome measurements to determine the level of efficiency in a more objective manner.”*

*“We have a Strategic KPI Scoreboard that reports performance on 12 measures.”*

**In your role, what types of information do you rely on to determine organisational effectiveness? (n=1,490)**



*“We try to meet Government imposed targets in a financially sustainable manner.”*

*“We have complex financial and KPI reporting arrangements that confuse staff. These are being improved, but even the improvements are not best practice.”*

### Performance measurement is strategic monitoring

Directors commented that it is important to focus on measures and measurement systems that most help the organisation to achieve its mission and not become distracted by the technology or data. Their key suggestions were:

- Measures of client impact should always take priority. This data enables organisations and other stakeholders to stay true to their e.g. mission and help them build and sustain client-centric cultures.
- Sound operational performance measures should be implemented before attempting to measure outcomes. There has been much of discussion of the use of outcome or impact measurement. Many organisations are now setting out to demonstrate their ‘social return on investment’. While this may be useful for attracting funding, boards need to ensure they have adequate financial and operational metrics, such as costing and pricing information, before attempting to implement more complex measures.
- Directors and CEOs will accept, even welcome, performance measures imposed upon them by funders or regulators where these aim to ensure quality standards are met (including standards for organisation governance) and to support performance improvement. They consider this ‘good’ red tape, but they also mentioned that there are still many externally-imposed, costly measures that have little or no utility.
- The cost of measurement systems and the return on investment should be monitored regularly. While performance data can be useful, this must be balanced against the cost of its collection. Some boards schedule annual reviews of performance measurement systems to ensure they are getting value for money.
- Directors acknowledge that there are many missions, goals and outcomes that cannot be measured (at least not yet) but nonetheless should be included in performance measurement systems as they are still powerful in engaging people and driving performance.

For example, it may not be possible to measure whether a boys’ school is ‘building good men’, a homelessness services provider is ‘breaking cycles of significant disadvantage’ or an arts organisation is ‘presenting the best work’, but in the right hands these statements encourage a constant and valuable reassessment of what the organisation hopes to achieve.

# What is performance measurement?

## Simplifying the conversation

As so much in the field is new, conversations about performance measurement for NFPs are often complex and inconclusive. Directors' experience, knowledge and perspectives are highly varied, as are the needs of the organisations they serve. As such, appropriate performance measurement is difficult, though not impossible.

## What are performance measures and performance measurement systems?

*Performance measures* are information products used to make decisions around assessing and improving performance. As such:

- There are generally a number of different users of performance information, each with different needs;
- Performance measures have a shelf life - the usefulness of the information deteriorates over time; and
- Performance measures require resources, including time and money, to produce;
- There are often a range of stakeholders and technologies involved in the production and consumption of the information.

*Performance measurement systems* are the processes and infrastructure used to collect the data required to produce performance measures. This will usually require both human and information technology resources.

Performance measurement can include assessments about the performance of individuals. As a result, there are both factual, as well as cognitive and emotional components to this work. The most effective performance measurement systems address the human elements, while also accurately defining and measuring activities and events.

## *Outputs and outcomes measurement*

An output is something that an organisation does and an outcome is something an organisation achieves.

While this is easy to differentiate in theory, in practice the line between output and outcome measurement is not always clear. For many NFPs, the delivery of services is a multi-staged process, sometimes involving a number of different organisations, that can occur over an extended period. An outcome for one part of the process may be simply an input for another.

*“There is attention to key measures but I do not believe that the question ‘Are we effective?’ has ever been directly posed and answered around the board.”*

How much does it cost to produce?  
What is the desired return on investment? Is it being achieved?

Is our data secure?

Who wants the data?  
What will they do with it?

Are we measuring what we are doing or what we are achieving?

## Questions for directors and boards

Is there any data we can stop collecting?

How has the data we provided last year been used?

Is the collection of data improving or diminishing the culture of our organisation?

How can we use data to encourage collaborative working and to support better individual accountability?

Do I need to build my own skills and abilities? In which areas?



Are we making NFPs report the same data multiple times? How can we avoid this?

How do we collect data from NFPs? Are there other ways it could be collected?

What would happen if we did not have this information from service providers?

## Questions for governments and other funders

How can we best use the data to design and build better services and improve effectiveness and efficiency of service delivery?

How much will it cost providers to collect and report this data? Is this justified by the benefit obtained?

Can we collect this data less frequently? Can we instead use sampling or other methods to reduce cost without reducing integrity or usefulness?

## 5. Challenging perspectives of the NFP sector

### Perceptions do not reflect reality

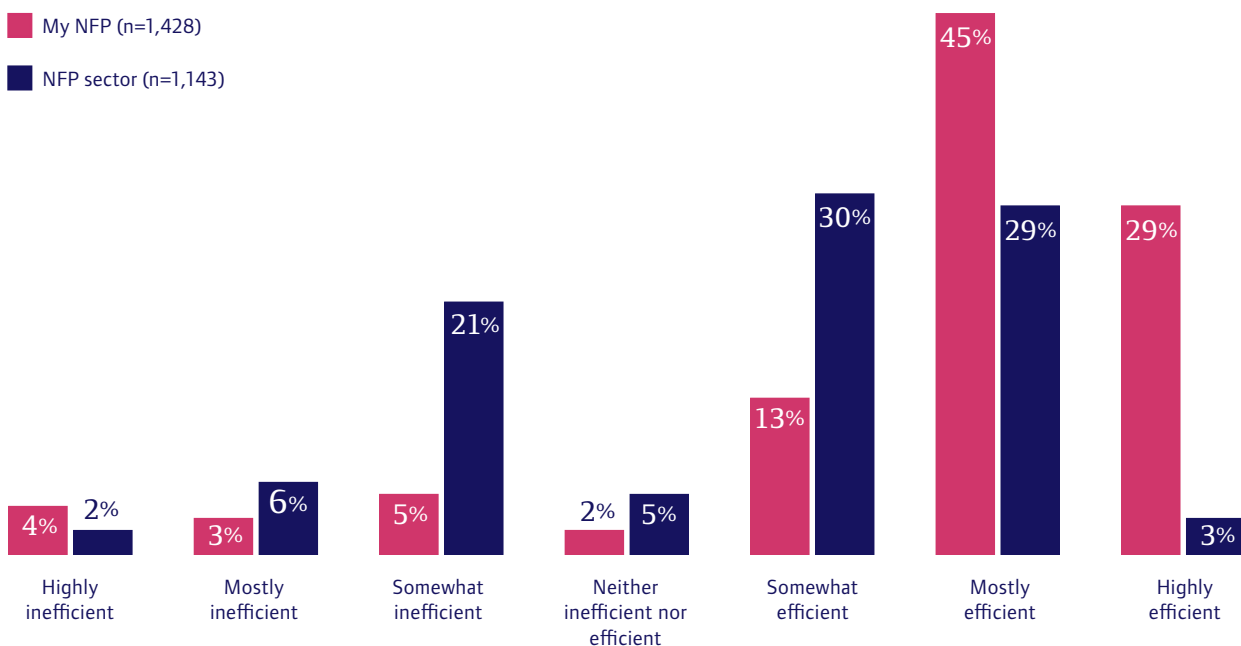
Over the course of this research, we have found that there are deep-seated and negative perceptions about the efficiency, effectiveness and commerciality of NFPs. These perceptions do not align with the reality of the modern, sophisticated and well governed NFPs of today.

Furthermore, we have been measuring these assumptions for several years and there has been little change.

### NFP Leaders still have a negative perception of the sector

Even NFP directors themselves have some negative perceptions of the sector as a whole, particularly when compared to how they see their own organisations. Consistent with the 2015 results, the 2016 study found that 74 per cent of directors believed their NFP is highly efficient or mostly efficient, but only 32 per cent believed this to be true of the sector. Indeed, 21 per cent believe the sector is 'somewhat inefficient'.

### Rating of efficiency of own NFP and the NFP sector as a whole



### The competitive advantage of NFPs

NFP leaders are often highly effective at leveraging the passion and commitment of others to maximise their impact and gather resources at little or no cost. Even very large and commercial NFPs seek donations, pro bono advice and utilise large volunteer workforces.

This is evidence of NFPs using good business strategy to enhance their impact and leverage a competitive advantage.

However, there is also a negative side to this strategy. Appearing 'poor and needy' and using a 'cap in hand' strategy reinforces the perception that NFPs are 'second class' organisations.

### Changing perspectives starts with the individual

The responsibility for redefining the perceptions of the NFP sector rests with the sector itself.

Fostering a more accurate understanding of NFPs will require deliberate and collective effort. At the individual level, directors and CEOs who work with NFPs should examine their own beliefs and behaviours to ensure that they are setting appropriate expectations and not reinforcing negative ones.

Advocacy organisations and peak bodies that support the sector should encourage and fund the collection of accurate data on NFP organisations, the quality of staff and services and their efficiency.

At some point, most NFPs need to shift from free to paid-for resources. Directors told us that one of the most important skills of the board of a growing NFP is to recognise when the time is right to do this. Relying on volunteers and donated equipment for too long can limit growth and create risk. There is a point at which it is prudent to pay for and have control over the organisation's resources.



### Low expectations about chief executives reinforce negative perceptions

We had noticed over the years that when discussing their CEOs some directors in the focus groups made statements like, ‘Our CEO is great - we are so lucky to have them.’ These statements indicate that some boards feel like their CEO is doing the organisation a favour by working for them.

We examined this issue more specifically this year.

*“Luckily he doesn’t want a big salary as his kids have left home. The office is close to where he lives.”*

A number of directors in the focus groups stated that their organisation is lucky to have a good CEO, implying they have someone who is overqualified for the role, or they were ‘getting away with’ paying less than market rate. Some suggested that the role was a ‘retirement job’ for their CEO.

We also found that many CEOs at NFPs do not have formal performance targets, perhaps because of the feeling directors have that their organisations are not worthy of their CEOs.

These findings suggest that some directors have lower expectations of CEOs and staff at NFP organisations. It also highlights the conflicting priorities of many NFPs to be highly efficient, effective and modern organisations, while remaining financially conservative. Participants in the focus groups recognised that they had to pay competitive salaries to recruit the right calibre of CEO, but they were also uncomfortable with the prospect of having a well-paid CEO.

The focus groups aired similar concerns regarding other areas of expenditure, such as buildings and property, ICT, marketing and training. Directors understand that these are essential investments, yet still feel uncomfortable if their staff have nice offices, high-quality computer systems or appropriate resources for training and development.

However, as with expectations of financial performance, this attitude was not present among all directors. Some were proud that they could attract and pay for a first-class CEO and fully expected to give that person challenging performance targets. These directors were usually also comfortable in having professional office space, quality equipment and investing in the skills development of staff.

*“No, he doesn’t have particular performance targets really, but we are lucky to have him.”*

## 6.

# It's time to re-think NFP-Government relationships

*“We need to be smarter in the way we communicate with government. The for-profits wouldn't tolerate it.”*

**Governments and the broader community must recognise that strong, financially sustainable and efficient NFPs are in the best interests of the sector, the community and government. At the same time NFPs must better understand and communicate with governments.**

**Governments need to take a different approach to funding arrangements.**

In our national reform document *Governance of the Nation: A Blueprint for Growth*, released in March 2016, the AICD called on governments to improve the funding of NFP organisations, including introducing best practice five-year funding cycles (where possible and appropriate).

In some cases, directors reported having to provide detailed information to government funders demonstrating their organisation is not making a profit. In some situations, governments prescribe a maximum amount of funding, often unrealistically low, that can be allocated to administrative expenses. This leaves NFPs needing to 'double dip' their administrative cost allocations across a number of contracts in order to fully fund their overheads.

To ensure a strong and competitive supply of services, governments need to take a more mature and less controlling approach to their portfolio of NFP suppliers.

Where possible they should contract for services on the same basis they do with for-profit organisations. As long as the quantity, quality and price is satisfactory, NFPs should be relied on to make their own decisions regarding cost allocation.

Similarly, NFPs need to ensure that they understand the full cost of service provision. If necessary, they should be prepared to walk away from contracts that will place the organisation at financial risk.

Directors noted how difficult this can be when faced with the prospect of being unable to fulfil their mission or losing valuable staff, but recognised that their own short-term focus on mission can create risk to the long-term survival of the organisation. Respondents described this situation as a ‘race to the bottom’ and explained that poor funding practice by government was the main reason they are seeking alternative funding sources, including through adopting social enterprise models.

It is not just the NFP sector that is not well-understood – perceptions of governments can also be shaped by rhetoric and opinion rather than fact.

### The NFP sector needs to clearly articulate what it wants from government.

In all previous studies, directors have commented on the need for governments to better understand and work with the NFP sector. This has been in a range of areas including creating more stability in policy, improving funding and contracting practice, and reducing red tape.

Reviewing the data over the last five years, it appears that little has changed, despite major initiatives such as the establishment of the Australian Charities and Not-for-profits Commission, state/territory government compacts with the NFP sector, and the development of longer-term contracts.

Data from the study shows that

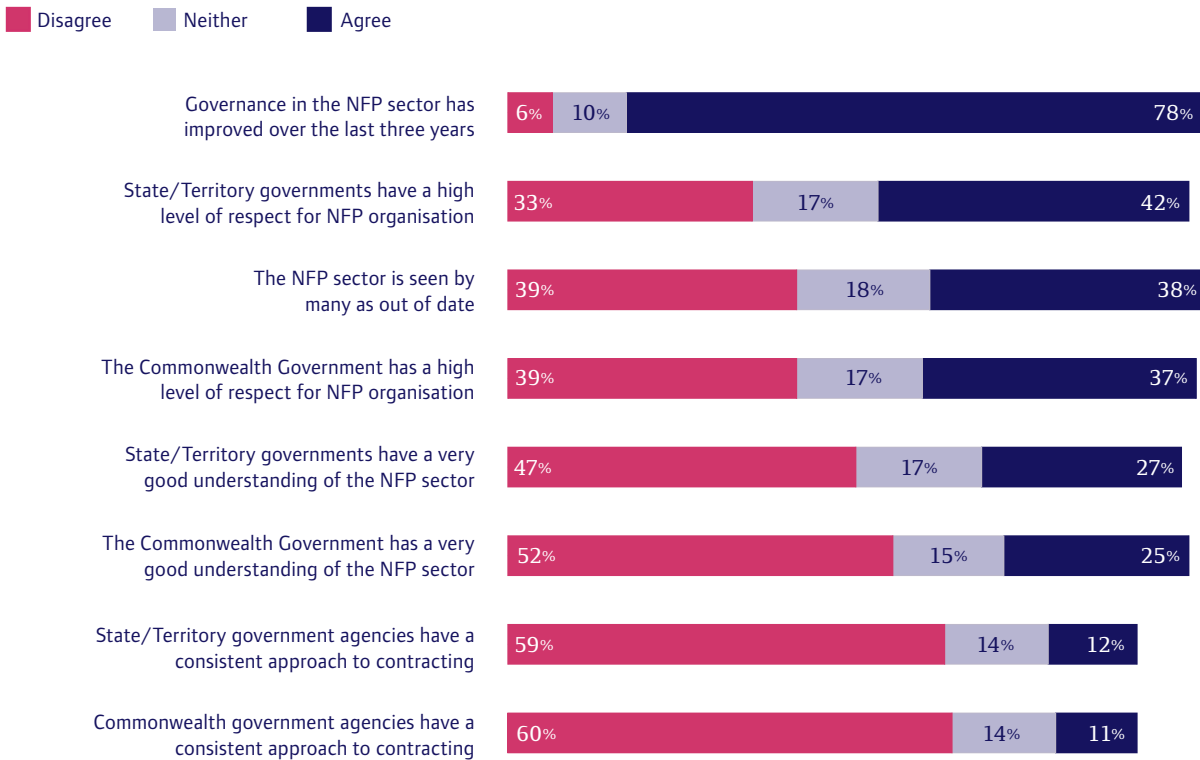
- More than half of directors believe that both the Australian, state and territory governments are not consistent in their approach to contracting;
- A third believe state and territory governments do not have a high level of respect for NFP organisations. Even more, albeit slightly, believe that the Federal Government does not have a high level of respect;
- Approximately 60 per cent believe that there is not a consistent approach to contracting across all Australian governments;

The AICD has called for a better model for funding contracts including 5 year agreements where possible and a one year notification on renewal of such contracts. We urge all governments to implement such agreements.

*“Bleeding us dry is pointless – we will just have to close and governments will end up with having to provide these services again.”*

*“Believe it or not, we (NFPs) don’t have magic money we can pull out of thin air.”*

### Opinions of NFP government relationships (n=1,138)

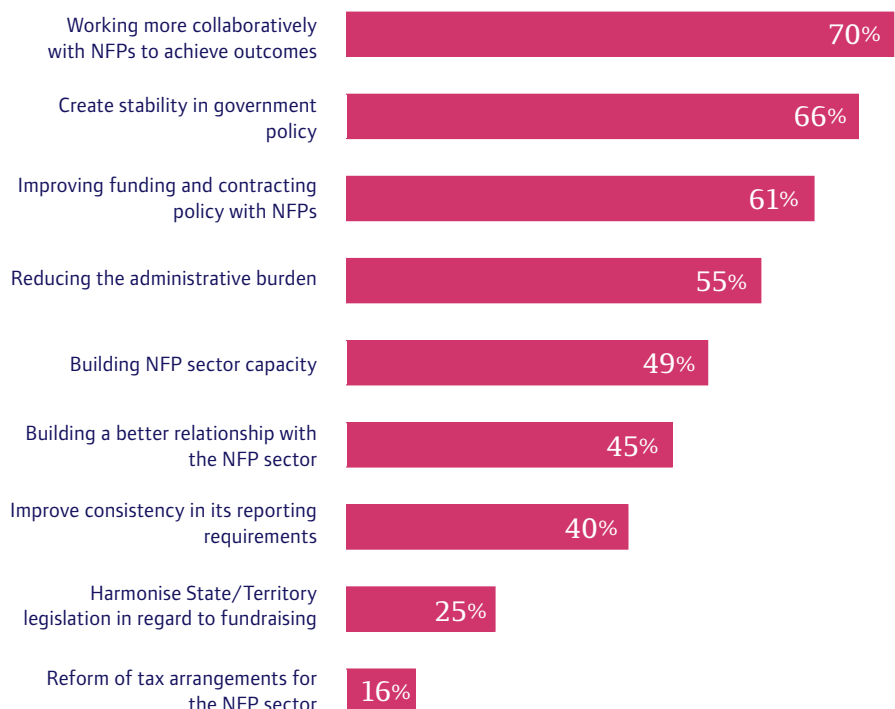


### Priorities for governments

We asked directors what their top three priorities are for government over the next three years and found that:

- 70 per cent of directors believe that governments should work more collaboratively with the NFP sector to achieve outcomes;
- Two-thirds want more stability in government policy;
- Just over 60 per cent want improved funding and contracting policy; and
- 55 per cent want the administrative burden reduced.

### Top 5 priorities for governments in the next three years (n = 548)



Are your funding and contracting policies exploiting NFPs' focus on mission?

Is your overall contribution to the sustainability of the sector positive or negative?

What impact is your funding policy having on the long-term viability of NFPs?

Is your contracting policy and approach consistent for NFPs and for-profits?

## Questions for Governments

Is there any data we can stop collecting?

Have we used a risk based approach with regard to funding agreements?

Are we consistent in our approach to reporting and are the reports used appropriately?

How can we use data to encourage collaborative working and to support better individual accountability?

Have you identified which NFP's are providing critical services and identified any alternatives in case of failure?



Who has developed that relationship and are we overly reliant on any one individual?

Do we understand the likely pressure points for government over the next couple of years?

Do we have an appropriate relationship with government and other funders?

Are we clearly communicating our success to the appropriate parts of government?

## Questions for NFP directors

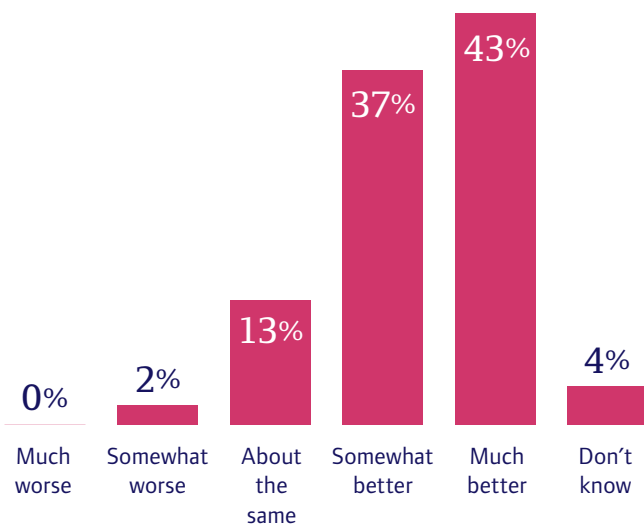
If we identify that there are particular problems, are we able to provide solution rather than just identifying the problem?

What is our process for accepting or refusing funding from government?

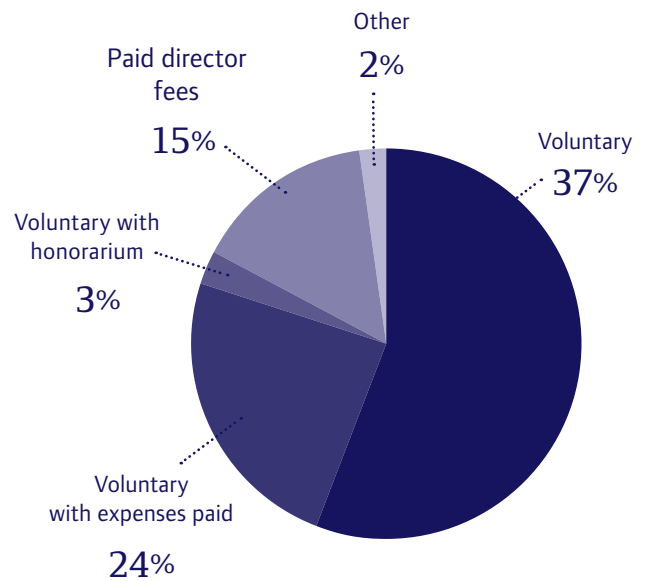
How do we determine the link between such funding and our overarching purpose?

# Key highlights

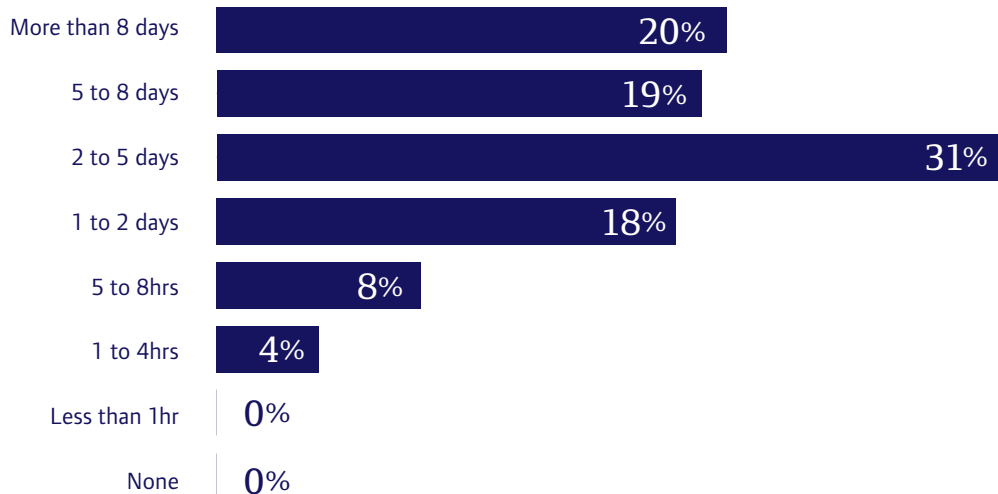
**Quality of governance compared with three years ago**  
(n = 1195)



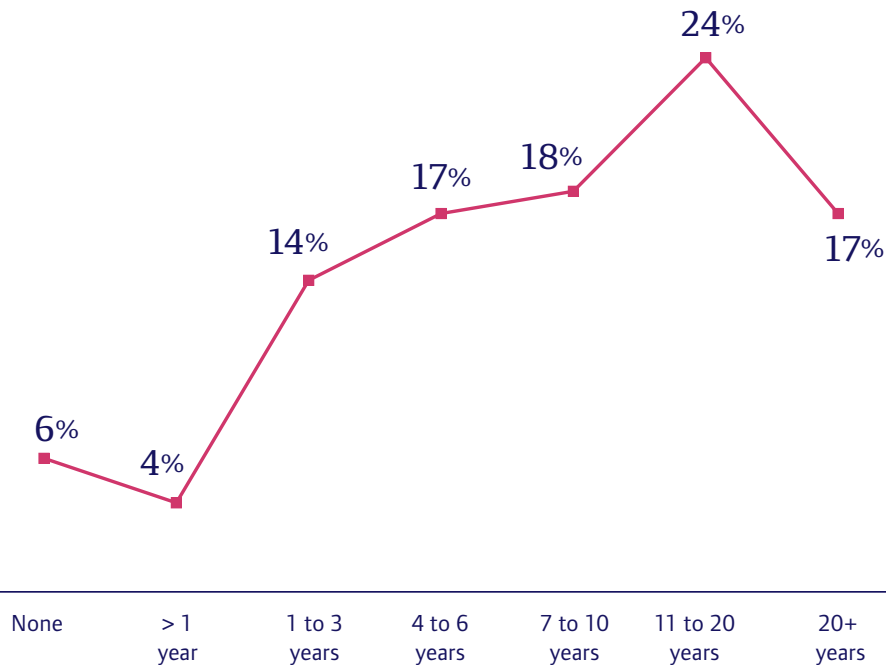
**Payment of Directors**  
(n = 1160)



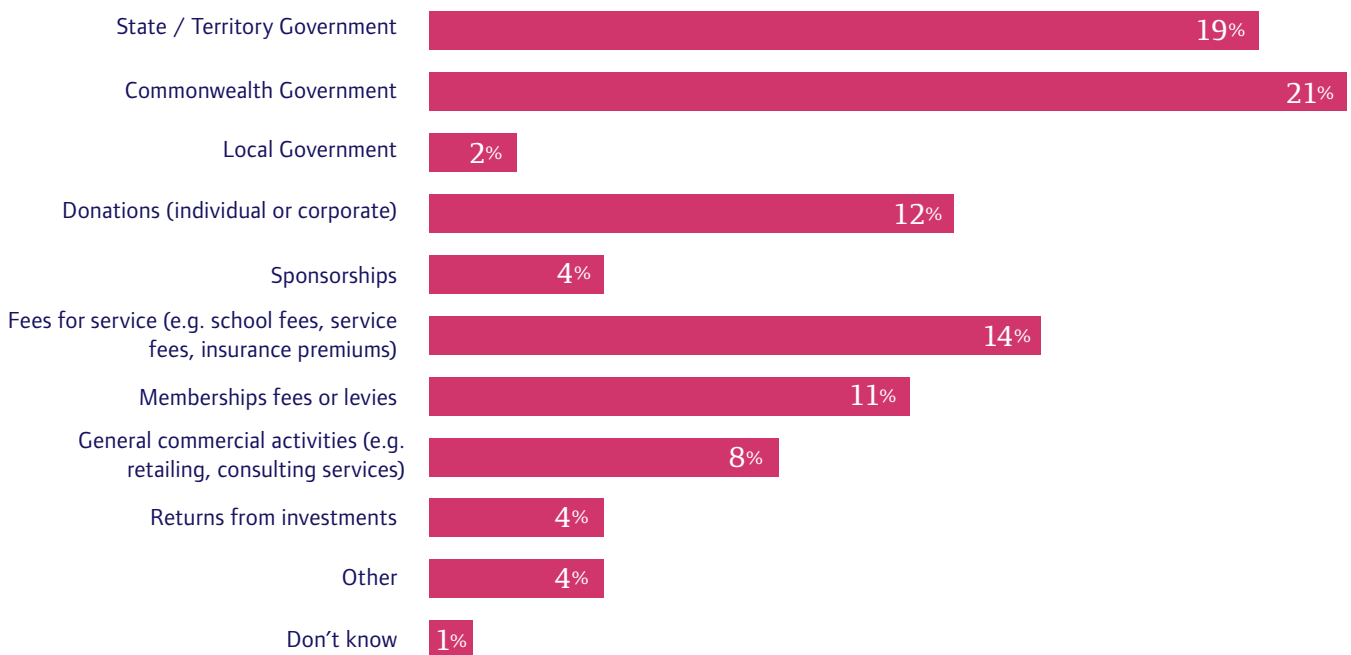
**Days/Hours per month on all NFP governance work**  
(n = 632)



**Years of experience as non-executive director of NFP  
(n = 1259)**



**Source of income (mean score) (n = 1437)**



## The data file

Key comparative data for the last four years of this study is presented below.

Please contact us if you would like further information.

	2013	2014	2015	2016
<b>Total sample</b>	<b>2,190</b>	<b>3,210</b>	<b>2,976</b>	<b>1,822</b>
<b>NFP income</b>	<b>1,198</b>	<b>2,265</b>	<b>2,471</b>	<b>1,478</b>
Under \$100k	7%	7%	7%	4%
\$100k to \$250k	7%	7%	6%	5%
\$250k to \$500k	7%	8%	8%	7%
\$500k to \$1m	6%	7%	8%	7%
\$1m to \$2m	8%	11%	10%	12%
\$2m to \$5m	15%	15%	16%	16%
\$5m to \$10m	11%	11%	11%	12%
\$10m to \$20m	12%	11%	12%	11%
\$20m to \$50m	15%	11%	10%	12%
\$50m+	12%	12%	11%	14%
Don't know	0%	1%	0%	1%
<b>Main sector of operations</b>	<b>1,199</b>	<b>2,240</b>	<b>2,475</b>	<b>1,500</b>
<b>Culture and Recreation.</b> Includes Arts	10%	11%	15%	9%
<b>Education and Research.</b> Includes primary, secondary, higher and vocational education	19%	17%	14%	14%
<b>Health.</b> Includes hospitals, rehabilitation, nursing homes (other than aged care), mental health treatment, crisis intervention, public health and wellness education, health treatment, primarily outpatient, rehabilitative medical services and emergency services	14%	15%	21%	18%

	2013	2014	2015	2016
<b>Social services and Aged care.</b> Includes child and youth welfare, disability services, residential and non residential aged care, emergency and relief, homelessness and income support	20%	20%	18%	26%
<b>Environment.</b> Includes animal protection	3%	3%	2%	4%
<b>Development and Housing.</b> Includes economic and social and community development in communities, housing assistance, employment and training	3%	3%	5%	4%
<b>Law, Advocacy and Politics</b>	1%	1%	2%	2%
<b>Philanthropic intermediaries and Voluntarism promotion.</b> Includes fund raising, grant making foundations and supporting volunteering	3%	2%	2%	3%
<b>International activities.</b> Includes promotion of social and economic development, cultural exchange, international disaster and relief, human rights and peace organisations overseas	2%	2%	3%	3%
<b>Religion.</b> Includes congregations and associations of congregations	2%	2%	2%	2%
<b>Business and Professional associations.</b> Includes labour unions	8%	8%	7%	6%
Not elsewhere classified	15%	16%	10%	8%
<b>NFP Structure</b>	<b>1,193</b>	<b>2,261</b>	<b>2,477</b>	<b>1,195</b>
Company Limited by Guarantee	44%	44%	47%	51%
Incorporated Association	34%	38%	38%	34%
Unincorporated Association	2%	3%	3%	3%
Body Corporate	1%	2%	2%	1%
Cooperative	1%	N/C	N/C	1%
Organisation established by Act of Parliament or Royal Charter	8%	N/C	N/C	6%
University Senate/Council/Board	7%	3%	2%	1%
Don't know		1%	2%	1%
Other	4%	9%	7%	0%

	2013	2014	2015	2016
<b>Charitable status</b>	<b>1,100</b>	<b>2,100</b>	<b>2,305</b>	<b>1,370</b>
Registered charity	45%	49%	58%	70%
<b>Source of Income (mean score)</b>	<b>1,198</b>	<b>1,642</b>	<b>2,482</b>	<b>1,437</b>
State/Territory Government	17%	19%	18%	19%
Commonwealth Government	21%	20%	18%	21%
Local Government	2%	3%	2%	2%
Donations (individual or corporate)	8%	11%	12%	12%
Sponsorships	7%	7%	8%	4%
Fees for service (e.g. school fees, service fees, insurance premiums)	13%	12%	12%	14%
Membership fees or levies	12%	10%	14%	11%
General commercial activities (e.g. retailing, consulting services)	11%	10%	8%	8%
Returns from investments	6%	5%	6%	4%
Other	2%	2%	3%	4%
Don't know	1%	1%	1%	1%
<b>Overall rating of effectiveness (score out of ten)</b>	<b>1,132</b>	<b>2,907</b>	<b>2,601</b>	<b>1,195</b>
	7.1	7	7.1	6.9
<b>Quality of governance compared with three years ago</b>	<b>N/A</b>	<b>1,911</b>	<b>2,373</b>	<b>1,195</b>
Much worse		0%	0%	0%
Somewhat worse		2%	2%	2%
About the same		12%	13%	13%
Somewhat better		37%	33%	37%
Much better		49%	44%	43%
Don't know		9%	8%	4%

	2013	2014	2015	2016
<b>Hours per month on all NFP governance work</b>	<b>1,110</b>	<b>1,108</b>	<b>1,201</b>	<b>632</b>
None	0%	0%	0%	0%
Less than 1 hr	0%	0%	0%	0%
1 to 4 hrs (up to half a day)	5%	2%	3%	4%
5 to 8 hrs (1/2 to 1 day)	15%	9%	11%	8%
1 to 2 days (9 to 16 hrs)	23%	23%	19%	18%
2 to 5 days (17 to 40 hrs)	33%	33%	33%	31%
5 to 8 days (41 to 64 hrs)	13%	16%	19%	19%
More than 8 days (64 hrs+)	11%	17%	14%	20%
<b>Hours per month on this NFP</b>	<b>1,010</b>	<b>2,383</b>	<b>2,601</b>	<b>1,038</b>
None	0%	0%	1%	0%
Less than 1 hr	0%	1%	0%	0%
1 to 4 hrs (up to half a day)	8%	10%	9%	6%
5 to 8 hrs (1/2 to 1 day)	24%	20%	20%	17%
1 to 2 days (9 to 16 hrs)	27%	31%	28%	27%
2 to 5 days (17 to 40 hrs)	28%	25%	26%	32%
5 to 8 days (41 to 64 hrs)	8%	9%	9%	11%
More than 8 days (64 hrs+)	5%	5%	7%	8%
<b>Payment of directors</b>	<b>1,007</b>	<b>2,298</b>	<b>2,592</b>	<b>1,160</b>
Voluntary	55%	58%	59%	56%
Voluntary with expenses paid	20%	23%	22%	24%
Voluntary with honorarium	5%	30%	4%	3%
Paid directors fees	19%	15%	13%	15%
Other (specify)	1%	1%	1%	2%

	2013	2014	2015	2016
<b>Merger data</b>	<b>N/C</b>	<b>1,958</b>	<b>2,259</b>	<b>1,139</b>
Discussed a merger		32%	32%	35%
Currently undertaking a merger		N/C	7%	8%
Completed a merger in the last 12 months		N/C	7%	6%
Discussed winding-up		N/C	8%	7%
<b>Likelihood to merge in the next two years</b>	<b>N/C</b>	<b>616</b>	<b>715</b>	<b>401</b>
Very unlikely		13%	10%	7%
Unlikely		16%	14%	10%
Somewhat unlikely		8%	11%	12%
Undecided		13%	14%	14%
Somewhat likely		23%	21%	20%
Likely		13%	12%	15%
Very likely		13%	18%	21%
Don't know		0%	0%	0%
<b>Gender</b>	<b>1,859</b>	<b>2,479</b>	<b>2,439</b>	<b>1,234</b>
Male	70%	63%	62%	61%
Female	30%	37%	38%	39%
<b>Age</b>	<b>1,857</b>	<b>2,485</b>	<b>2,439</b>	<b>1,304</b>
20 to 29	0%	0%	1%	1%
30 to 39	5%	5%	4%	6%
40 to 49	23%	22%	19%	18%
50 - 59	41%	41%	40%	40%
60- 69	26%	27%	30%	29%
70+	5%	5%	6%	6%



	2013	2014	2015	2016
<b>Years experience as non-executive director of NFP</b>	<b>1,829</b>	<b>2,483</b>	<b>2,392</b>	<b>1,259</b>
None	26%	9%	1%	6%
Less than 1 year	3%	3%	4%	4%
1 to 3 years	13%	16%	17%	14%
4 to 6 years	15%	18%	20%	17%
7 to 10 years	15%	19%	20%	18%
11 to 20 years	17%	21%	23%	24%
More than 20 years	10%	13%	15%	17%
<b>Years experience as non-executive director of For-profit</b>	<b>1,794</b>	<b>2,455</b>	<b>2,345</b>	<b>1,229</b>
None	38%	46%	44%	46%
Less than 1 year	3%	2%	2%	2%
1 to 3 years	10%	8%	10%	8%
4 to 6 years	11%	9%	9%	8%
7 to 10 years	11%	9%	9%	9%
11 to 20 years	15%	14%	13%	12%
More than 20 years	12%	12%	14%	15%
<b>Location</b>	<b>1,864</b>	<b>2,480</b>	<b>2,440</b>	<b>1,299</b>
New South Wales	27%	27%	28%	32%
Victoria	25%	29%	28%	25%
Queensland	16%	15%	15%	15%
Western Australia	13%	11%	12%	11%
South Australia	7%	8%	7%	7%
ACT	4%	3%	4%	6%

	2013	2014	2015	2016
Tasmania	3%	4%	4%	3%
Northern Territory	1%	1%	1%	2%
Outside Australia	3%	1%	1%	0%

## The research method and sample

### Research Method

The 2016 study involved

- Eight focus groups conducted with a total of over 50 directors. Five groups discussed general governance issues, while three discussed financial sustainability
- Five individual interviews, including with directors in the health sector.
- An online survey emailed to 1,822 AICD members during May 2016.

### The survey sample

The profile of respondents to the 2016 study was very similar to that of previous studies.

#### Total respondents

A total of 1,822 people responded to the survey. Of these, 1,600 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.

### Size categories

	Income last financial year	Our respondents	ACNC Charities data <sup>2</sup>
Very small	Less than \$250k	13%	64%
Small	>\$250k to \$1m	16%	17%
Medium	>\$1m to \$5m	26%	
Large	>\$5m to \$20m	24%	19%
Very large	More than \$20m	21%	

### Focus groups

#### Darwin

General governance  
Financial

#### Brisbane

Interviews

#### Toowoomba

General governance  
Financial

#### Sunshine coast

General governance  
Financial

#### Sydney

General governance  
Financial

#### Perth

General governance

<sup>2</sup> 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.

## 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 38,000 includes directors and senior leaders from business, government and the not-for-profit sectors.

## BaxterLawley

### BaxterLawley

4/8 Hampden Road, Nedlands WA 6009

### Penny Knight

t: 08 9384 3366

e: penny.knight@baxterlawley.com.au

baxterlawley.com.au

BaxterLawley conducted the NFP  
Governance and Performance Study  
2016 on our behalf.

## 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

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**A** strong not-for-profit (NFP) sector is critically important for Australia's society. Organisations in the sector deliver vital services to some of the most vulnerable members of our community, across a diverse range of sub-sectors.

The 2016 NFP Governance and Performance Study continues the trend of previous studies in highlighting the key themes, challenges and opportunities facing the sector.

The study, which is the largest of its kind in Australia, continues to provide key insights to Government, Donors and the Sector on current and future issues facing our society. The study has become the primary source of information relating to NFP governance in Australia.