AUSTRALIAN INSTITUTE of COMPANY DIRECTORS

2017

NFP Governance and Performance Study

Australia's NFP Sector

Building long-term strength

CommonwealthBank

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

In looking back over our involvement with the study over the past three years, it is interesting to note the similarities in challenges which continue to be faced by the sector. What is also clear is the adaptability and resilience of NFP organisations as they turn existing and new challenges into opportunities. It is also a sector which continues to embrace innovation at a rate unmatched by any other sector of the Australian economy.

There will be challenging times ahead and we are committed at CommBank to continue to work and partner with organisations operating in this area, along with governments and regulatory bodies, as the sector continues to adjust to a new funding model and the challenges heralded from a user choice environment.

There are probably no surprises to read in the 2017 study that financial sustainability continues to be very firmly on the agenda. There was also widespread recognition amongst survey participants that financial health is impacted by a variety of factors including organisational reputation and brand integrity, and the ability to nurture and maintain a positive organisational culture.

Last year's study touched on the need for conversations to be had regarding changing current government funding cycles from 12-month terms to three years or longer. Following on from this, it was particularly pleasing that CommBank's Community Grants program this year moved away from its 12 month grant funding cycle and implemented, for the first time, a new three year financial model.

It is anticipated that in reducing the administrative burden of yearly funding applications, NFPs and their staff will be in a better position to focus on the delivery of their vision and mission. Perhaps even more importantly, the adoption of the new longer-term funding model will provide greater certainty regarding the ongoing viability of programs and activities which benefit Australia's youth and, in turn, the wider Australian community.

I hope you find the insights and commentary in the 2017 AICD NFP Governance and Performance Study of interest, in what has become a highly anticipated and respected report, and also the largest body of research of its kind undertaken within the Australian NFP sector.

Regards,

Julienne Price
Head of Not-for-Profit
and School Banking
Commonwealth Bank of Australia

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Foreword by Elizabeth Proust AO FAICD

Welcome to the eighth annual NFP Governance and Performance Study.

This study remains a cornerstone of the Australian Institute of Company Directors' (AICD) commitment to supporting not-for-profits (NFPs) achieve better outcomes through good governance. For eight years this research has provided a snapshot of how the sector is faring, as well as lessons for NFP leaders, governments and regulators in how together we can strengthen the sector.

Currently, NFPs are experiencing a period of unprecedented change. They face an evolving regulatory landscape, the emergence of new funding models and an increasingly complex operational environment, which combined mean governance has never been more important for the sector.

This year the study examined how, during this time of disruption and change, NFPs are building foundations for long-term success. We explored issues of organisational culture, along with risk and reputation management. We also revisited the financial challenges faced by the sector to dive deeper into directors' attitudes to financial management, particularly in making profit.

The results revealed that while many directors believed their organisation was performing well, there were often not the appropriate formal controls or monitoring of processes being undertaken at board level.

For instance, while most directors rated their organisation's culture highly, more than half of directors said that culture had not been formally part of their board agenda in the last year. Similarly, while most directors thought their NFP took an appropriate level of risk, half of directors reported no formal risk management statement. Underscoring the results from last year's study, there were still many NFP's barely breaking even and directors who were uncomfortable with the idea of NFPs making a profit.

This year has been a big year for the AICD in the work we do to support NFPs and their directors more broadly. We ran the first of our NFP Sector Forums in Melbourne and Perth, launched a new communications channel for NFPs – the NFP Quarterly Update – and announced 140 scholarships across Australia which will provide assistance for the directors of smaller NFPs to participate in our courses and events.

In addition to the online survey, this year's study comprised several focus groups held in Adelaide, Alice Springs, Perth, Melbourne and Sydney. All directors in the focus groups were generous with their time and candid in their views. We thank them, as well as those who completed the online survey for contributing to the research.

We hope that the study will incite meaningful conversations among NFP boards around Australia. Included in this year's study are 'questions for boards' which aim to encourage directors to make use of the findings of this study to inform discussions in Australian board rooms.

We trust that you and your NFP find it insightful and helpful.

Elizabeth Proust AO FAICD
Chairman
Australian Institute of Company Directors

Building on strong foundations

The NFP sector continues to be a vital contributor to the Australian community and economy. NFPs of all kinds and sizes are involved in almost every aspect of Australian life, from local sporting clubs to large healthcare providers.

Over the last eight years, the AICD's NFP Governance and Performance Study has challenged perceptions about the standard of governance across the sector. The research has shown that despite the manifold challenges involved in NFP governance – in achieving mission success with limited funding and facing a complex operational environment – NFP boards have performed with distinction, belying any belief that governance is lagging the for-profit sector.

Over that time, many NFPs have actively invested in improving governance as its importance to organisational success has become widely recognised and as compliance pressure has come from funding and regulatory bodies. The AICD has supported this effort, providing resources, information, scholarships and professional development opportunities for NFP boards and the large proportion of our 40,000 members that are involved in the NFP sector.

The NFP Governance and Performance Study each year provides a unique data set drawn from the insights of our NFP members on how the sector is faring and also on those areas where collectively the sector can work to improve. In its eighth year, the study has focused on how NFPs can build on the strong foundations boards have already laid down for organisational success. This study examined those areas – strong cultures, risk and reputation management, and financial sustainability – that are essential if NFPs are to continue to thrive in the long-term.

Trust – from society, from government, from donors and from clients – in the NFP sector is critically important in it achieving its goals. Strong cultures and reputations build trust between stakeholders and NFPs.

This was recognised close to universally by the directors who took part in this year's study. NFP directors understand how central these areas are to good governance. However, this year's research has also revealed that NFP boards could do more to get feedback on and actively oversee both culture and reputation.

Setting and overseeing the risk policy of an organisation is a fundamental responsibility of a board. Organisations need to understand the risks they are taking and put in place appropriate steps to mitigate them. At the same time, though, being unwilling to take appropriate risk limits an organisation's capacity to achieve its mission. While the study found that many organisations have very sophisticated risk management systems, this was not the case across the board. The research shows that more work could be done across the sector to share best practices in risk management.

As in previous years, financial sustainability continues to be a major concern for many NFPs and their boards. Many directors reported that their organisations had profit margins that would threaten their long-term survival. This year's research underlined the key finding from last year's study that the NFP community, as well as government and donors, need to continue the conversation to change attitudes around profit. NFPs can and should make profits to ensure their long-term sustainability and financial strength.

Note: Due to rounding, percentages on graphs may not add to 100.

1.

Culture front of mind, but bottom of agenda

A strong culture is a hallmark of successful organisations.

Culture refers to shared values, beliefs, norms and practices, all of which can profoundly influence an organisation's capacity to achieve its purpose. Culture is sometimes referred to as "the way we do things around here" and as such affects every aspect of how the staff and volunteers of NFP interact with each other

For the people involved with an NFP, these unwritten rules set expectations of what is acceptable and unacceptable. Culture is a key driver of how people behave when no one is watching and is a central force in the formation of an organisation's ethics.

Organisational culture is a key reason people choose to work and volunteer with NFPs. A collective sense of mission and purpose is an attractive proposition to potential team members, and compares favourably to the financial focus of for-profit companies.

Getting culture right is fundamental to achieving an organisation's mission and strategic objectives. Strong culture is critical to building morale within a workforce, creating cohesive teams, and ensuring high standards of integrity. Performance and culture are inextricably linked.

By comparison, poor culture can undermine an organisation's ability to achieve its goals. It can lead to disengagement from stakeholders, increased absenteeism, and difficulty in attracting and retaining talented staff and volunteers. Poor culture can also erode the trust of donors and government, endangering funding, and can increase the risk of legal or regulatory action. At the most extreme, poor cultures can lead to harm for clients, who are often among the most vulnerable in the community.

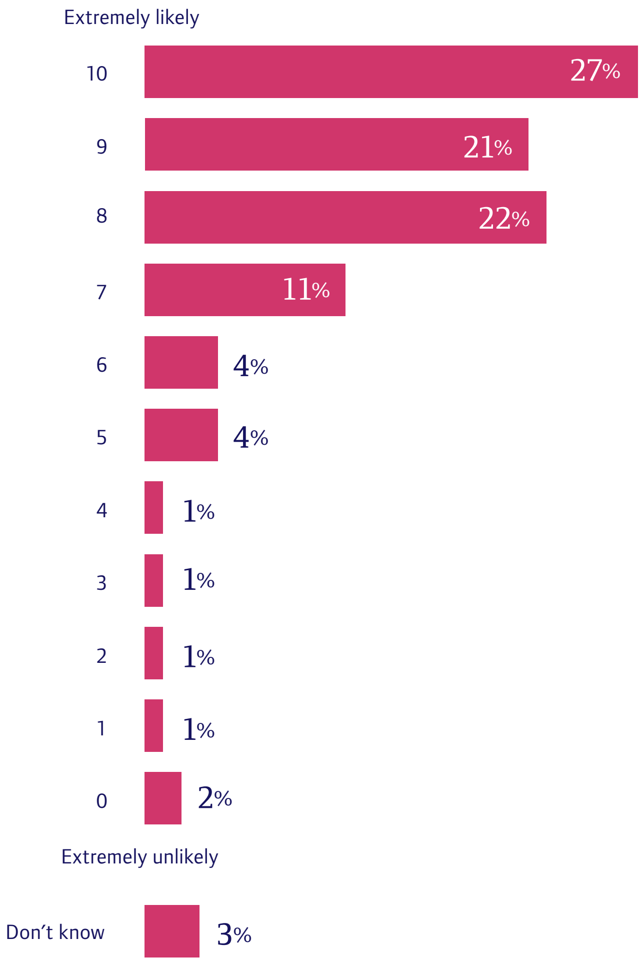
Signs of a weak or problematic organisational culture may include:

- High staff turnover and disengagement;
- Prevalent bullying or workplace injuries;
- Frequent complaints from stakeholders, especially when not dealt with;
- Low respect for and compliance with organisational policy;
- Intolerance for differing opinions; and
- Reluctance to talk about culture.

Distilling a sense of culture at one organisation is challenge enough, let alone taking a snapshot of culture across a sector as diverse as the NFP sector. This study approached issues of culture in a number of ways, asking directors to rate their organisation's emphasis on culture and to evaluate their performance in managing it within their organisations. The ultimate aim was to understand how NFP boards are performing in establishing strong cultures.

Directors see their cultures as strong

Fig 1: On a scale of 0 to ten, how likely are you to recommend this NFP to your friends or family as a place to work?
n = 1,313



As a way of measuring organisational culture from a personal, rather than theoretical, perspective, we asked directors how likely they would be to recommend their NFP as a place of work to friends or family. Willingness to recommend the organisation to friends and family is treated as a proxy for how the directors perceive culture at their organisation. Directors would consider issues such as staff morale, whether they nurture their employees and whether generally they are 'good' places to work, both in terms of their values and in the sense of work satisfaction.

Most directors gave a resounding endorsement of their organisation as a place to work. More than 70 per cent would be very likely (8 or above) to recommend their organisation to friends and family.

This was also reflected in the comments from directors in the focus groups. Directors noted the commitment, passion and engagement of their organisation's staff in making an impact on people's lives. They also pointed to harmonious and supportive workplace environments at their organisations.

Most directors believe that their organisations are great places to work.

"We value our employees and do meaningful work", said one director. "Our organisation has a committed and caring environment that has been operating for almost 120 years," said another. The pride of many directors in overseeing healthy workplace environments was obvious from the focus groups.

A small minority of the directors surveyed – one in ten – would not be likely to recommend their organisation as a place to work, giving a rating of five or below. For the most part, however, this group of directors cited operational difficulties, rather than cultural problems, as motivating their decision. These challenges included reductions in funding, uncertainty of employment and lack of resources. This result underscores how important it is for government to provide certainty around funding and resourcing to NFPs. The AICD continues to advocate for a best practice funding model of five-year cycles and 12-month notice periods of termination of funding.

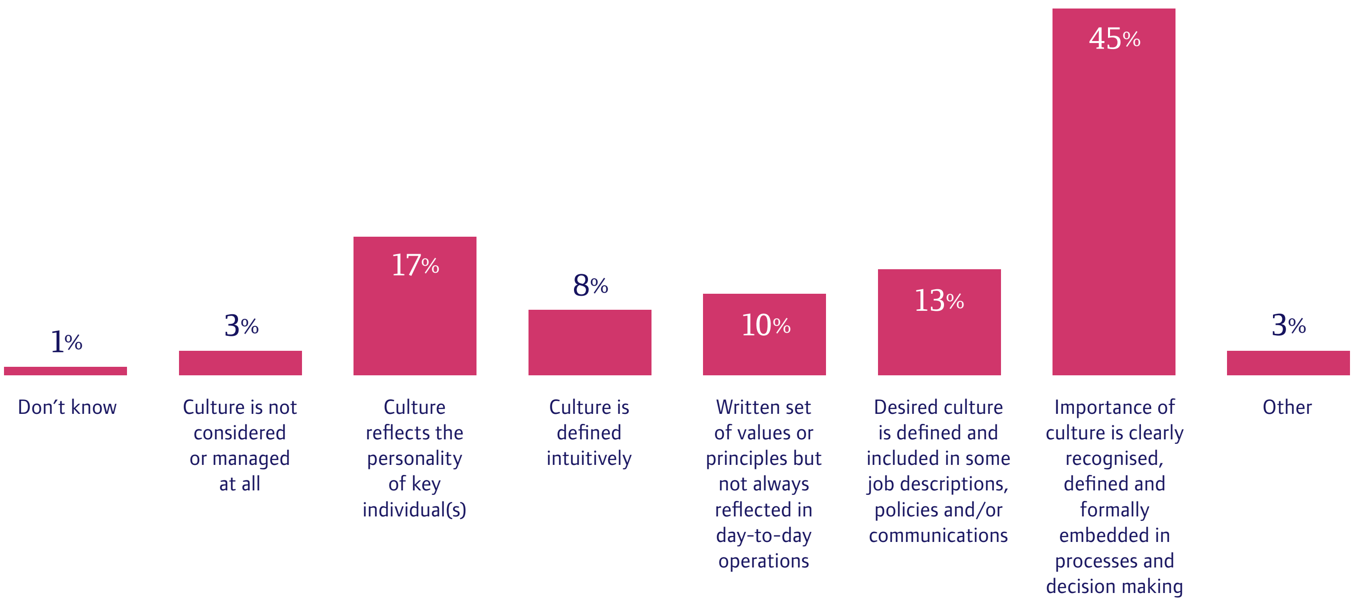
Some directors identified poor leadership and governance, and out-of-date practices as the reasons for their low score on the question.

"It is currently a patriarchal organisation that resists change and especially improved governance, but we are getting there slowly," a director with similar frustrations said in the focus groups.

Nonetheless, it is clear that generally directors believe the NFPs they govern have strong cultures, making them favourable places to work.

Culture is strong, but not clearly defined

Fig 2: How is your organisation managing culture?
n = 1,313



Although the culture of an organisation can appear to be intangible, there is increasing awareness of the need for boards and management to set, demonstrate and actively create the culture they would like to see in their organisation.

There are many practical ways for boards to take a hand in shaping organisational culture. Many boards formally define an ideal culture and work with staff and stakeholders to develop strategies to achieve it. For example, establishing codes of conduct around ethical standards (and ensuring that these are communicated, understood and adhered to) can be a powerful way to send a message about cultural expectations.

The selection of a CEO and senior leadership team can be a significant influence on culture, and it is commonplace now to see cultural factors as essential components of executive performance evaluation frameworks. Because of the impact that an executive team can have on culture, it is prudent to establish reporting guidelines and robust whistleblower programs to ensure that behaviour outside the bounds of the expected culture are brought to the attention of senior leaders and the board.

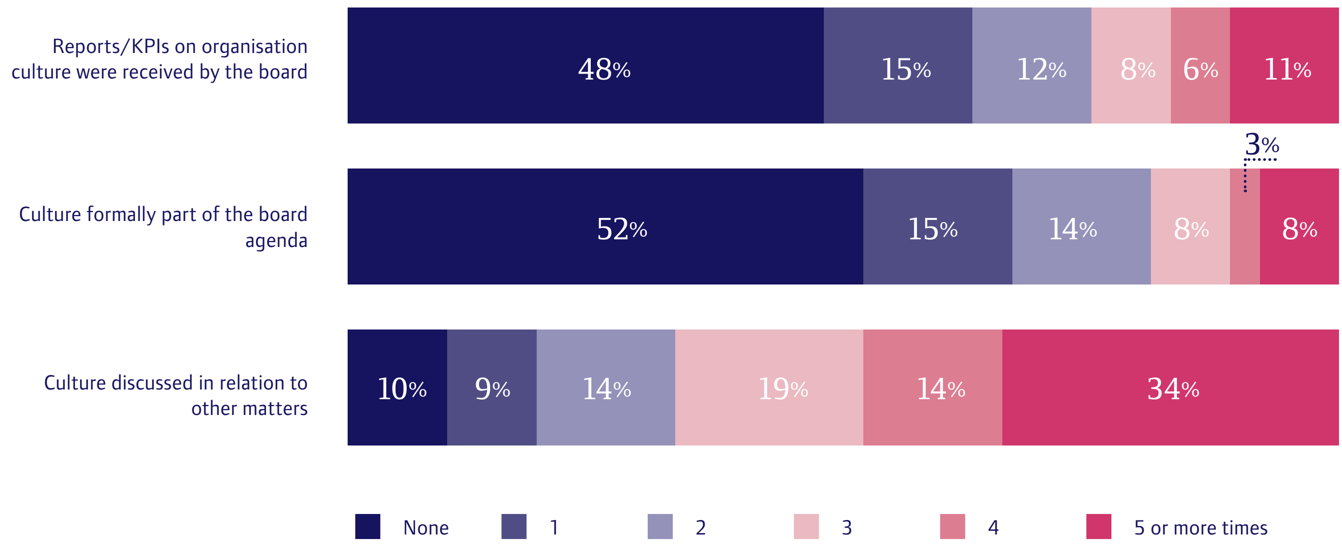
Although NFP directors do not believe their organisations have weak cultures, few are taking proactive steps in managing culture.

Fewer than half (45 per cent) of the directors surveyed said the culture of their organisation was clearly defined and formally embedded in their systems and policies. Thirteen per cent said the desired culture was defined, but that it had only been included in some job descriptions and policies.

Although only three per cent of directors said that culture was not considered or managed at all, many organisations had an underdeveloped or informal approach to managing culture. A quarter of directors surveyed said that either the culture of their organisation reflects the personality of key personnel, or the culture of the organisation is defined intuitively.

Culture needs to be on the board agenda

Fig 3: Number of times culture on board agenda in 12 months
n = 1,260



Even among the group of directors who said that their organisation's culture had been clearly defined and formally embedded, most said that oversight at the board level was minimal.

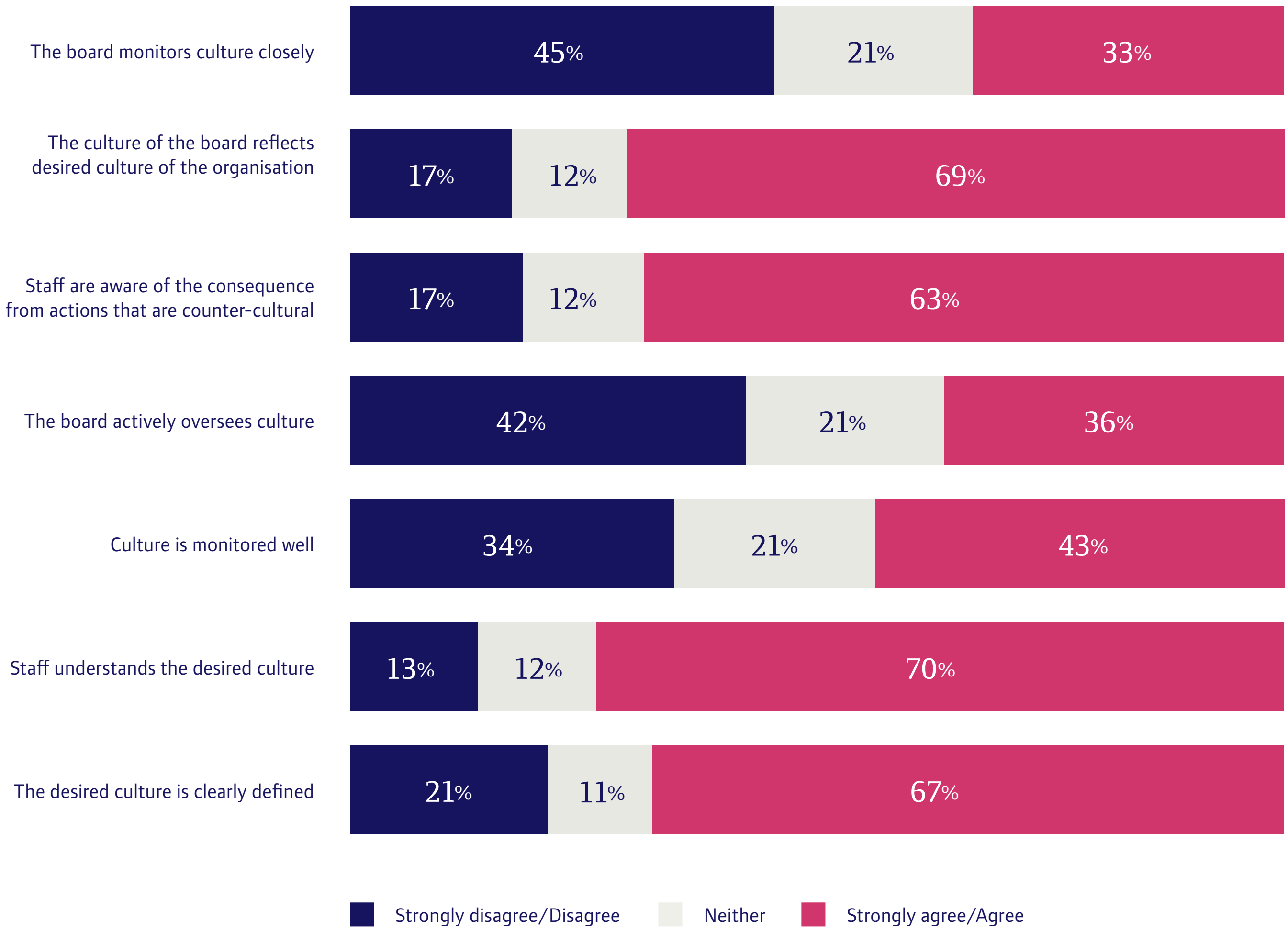
Of this group:

- More than a third (36 per cent) reported that culture had not formally been part of their agenda for 12 months;
- A third (29 per cent) said that their board did not receive reports, or set organisational KPIs, based on culture; and
- Nearly half (46 per cent) said that culture had been discussed at the board level at least five times in the last twelve months, but, importantly, only when it arose in regard to other matters.

Overall, more than half (52 per cent) of directors surveyed said that culture was not formally part of the board agenda in the last 12 months, while 48 per cent said that they had not received any reports on organisational culture in the same time period.

The majority of boards do not address culture formally at all.

Fig 4: Effectiveness of culture oversight
n = 1,260



'Don't know' and 'not applicable' responses are not shown.

More than half (55 per cent) of directors reported that culture at their organisations is not being monitored well and only one third say their board is actively overseeing culture. Despite this, the great majority believe that staff understand the organisation's desired culture (70 per cent) and are aware of the consequences of actions that are counter to the culture (63 per cent).

Directors believe their organisations have positive cultures but there is little evidence of formal systems or controls for culture.

Many directors in the focus groups acknowledged their boards could be doing more to shape the culture of their organisations. For some directors, culture did not find its way onto the agenda because it was felt to be embedded within board discussions on other issues. For others, culture was on their minds, but there was a lack of knowledge about how boards could take control of the issue.

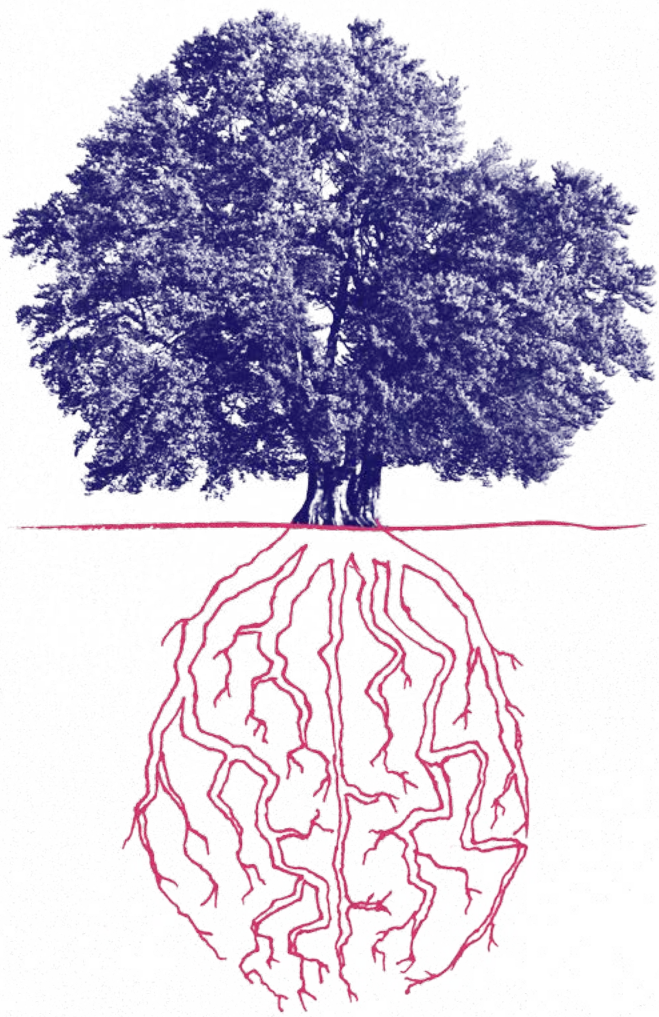
The fact that many NFP boards are not actively considering culture as part of their agenda, or setting and embedding cultural expectations for their organisation, does not necessarily mean the culture at those NFPs is deficient.

The vibrancy and general success of the NFP sector suggests this is not so. Strong cultures can also emerge through informal, organic processes, possibly based around strong personalities at the organisation and a deep sense of shared vision and purpose.

However, culture is too important to be left to chance and boards should take an active role in managing culture.

Weak and unhealthy cultures pose grave risks to the success of an NFP. At the very least, culture should be the subject of regular reporting and active steps should be taken to address any deficiencies.

The AICD's Good Governance Principles and Guidance for Not-for-profit Organisations notes that the board and its individual members have a leading role to play in promoting a healthy culture for the organisation they serve.



Questions
FOR DIRECTORS

- Has our ideal culture been formally recorded and communicated to staff and volunteers?
- Do we know what our current culture is? Is it the right culture for us?
- How do we monitor the development of our culture?
- Who is responsible for our culture? Is there a framework to keep them accountable?
- Has the board developed a code of conduct, and set of values and behaviours to guide board members, staff and volunteers?
- How does the board hold itself accountable for compliance with its formal code of conduct and ethical standards?
- Does the chair proactively lead board culture and ensure the active engagement of all directors?
- Is there a whistleblower policy for the reporting of wrongdoing? How does the board hear about this?

2.

Management of risk highly variable

There is a widely-held view that the NFP sector is more risk averse than the for-profit sector. The perception is that NFPs lag in terms of innovation because they are more conservative in their approach, less open to new ideas and, as a result, less likely to experiment.

This year's study found the issue is considerably more complex.

Many NFPs operate in high-risk environments, such as those providing services to vulnerable people, administering complex healthcare systems or working within heavily regulated contexts. Factors such as these can significantly influence the risk-taking attitudes of NFPs and their directors.

Others are faced with intractable problems and have no choice but to take risks in pursuit of achieving their missions. For some segments of the NFP sector, finding new solutions to old problems is the norm, and accepting a degree of risk is an important part of their business.

Setting and overseeing the risk policy of an organisation is among the fundamental responsibilities of a board. Boards must make sure there is appropriate risk oversight to identify, mitigate and respond to risks if they materialise. The purpose of a risk management framework should be to empower NFPs to negotiate the effect of uncertainty on their objectives.

NFPs that are unwilling to take risk may fall behind the pack.

Risk is inherent in operating an organisation, and being unwilling to take appropriate risk may limit an organisation's capacity to achieve its mission.

In a commercial sense, organisations that are overly risk averse generally achieve lower returns on investment than would be optimal with a prudent risk assessment. In the context of scarce funding faced by many NFPs, being overly risk averse in the short-term can be counterproductive to long-term viability.

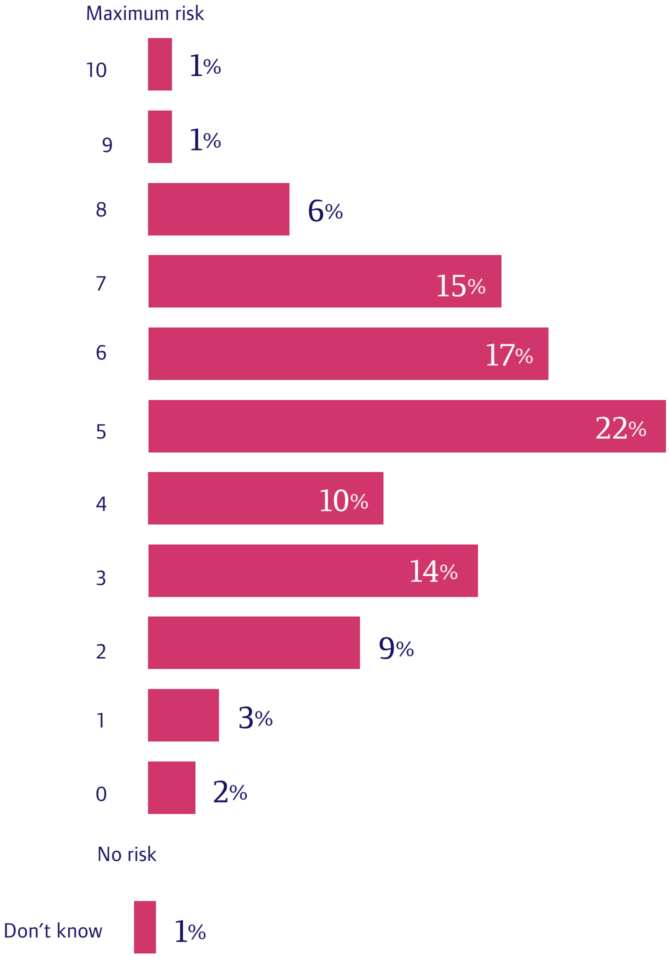
For many NFPs their ability to achieve their purpose relies upon them showing they have appropriate risk management controls, systems and processes in place. For example, some NFPs may be required to achieve certain standards in risk management to be accredited for the delivery of certain services.

There may also be legal, financial and compliance obligations that require NFPs to approach risk management in a certain way.

The study examined whether directors felt the level of risk was appropriate for their organisation and the practices employed by their boards to oversee those risks.

There is no one risk story

Fig 5: Amount of risk taken
n = 1,292



NFPs are involved in an incredibly diverse variety of work, from sporting clubs to hospitals, religious congregations to theatre companies – there are few parts of our community in which the sector is not involved. Accordingly, the types of risk faced by NFPs and their approach to managing these risks varies significantly.

To gauge the level of risk NFPs are taking, the survey asked directors to place their organisation on a risk spectrum from zero to ten, with zero being absolutely intolerant of any risk and ten being willing to take on maximum risk.

Around half of the directors (49 per cent) placed their NFPs around the middle values (between 4 and 6), while just over a quarter (28 per cent) of directors considered their organisation as risk-averse (3 or lower) and just under a quarter (23 per cent) saw their organisations as risk-willing (7 or above).

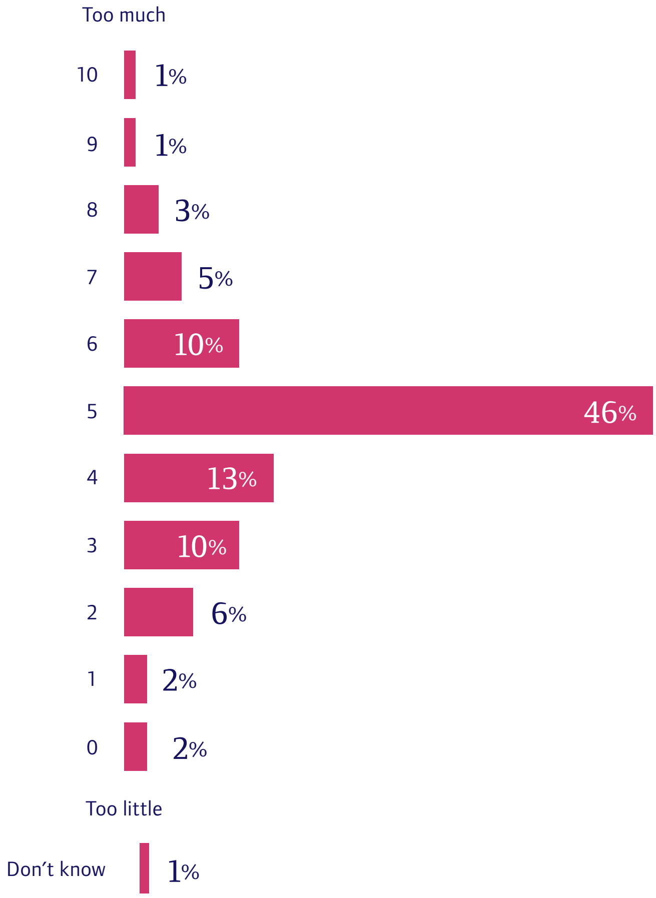
"To provide the services we do in the places we do involves risk that many companies would never dream of."

The focus groups painted a similar picture with many directors frustrated by the idea that NFPs take on lower levels of risk than their for-profit counterparts. "To provide the services we do in the places we do involves risk that many companies would never dream of," one director said.

At the same time, there were directors who said their organisations were very hesitant to take risks. "With a board chair that changes every two years, and a regular two yearly turnover of directors, there is a constant fear of 'not on my watch'," said another.

The results from this year's survey on general risk management support last year's findings on financial risk management, which showed significant diversity in approach to leveraging financial assets to grow an organisation's capacity.

Fig 6: Appropriateness of risk taken
n = 1,290



The study also asked directors to evaluate whether the level of risk taken by the organisation was appropriate to their circumstances. To do this, directors were asked to rank the appropriateness of their risk taking on a scale of zero (not enough risk) to ten (too much risk).

On balance, more directors felt their organisation was taking on too little rather than too much risk.

Around a third of directors (33%) felt their organisation was not taking on enough risk (rating their organisation four or less), while only one in five thought their organisation is taking on too much risk (rating it six or above).

Generally, directors perceived that the level of risk their organisation was taking was appropriate, with just under half (46 per cent) of directors rating their organisation's risk appropriateness at five – just right.

Formal risk management underdeveloped

Fig 7: Maturity in risk management
n = 1,294

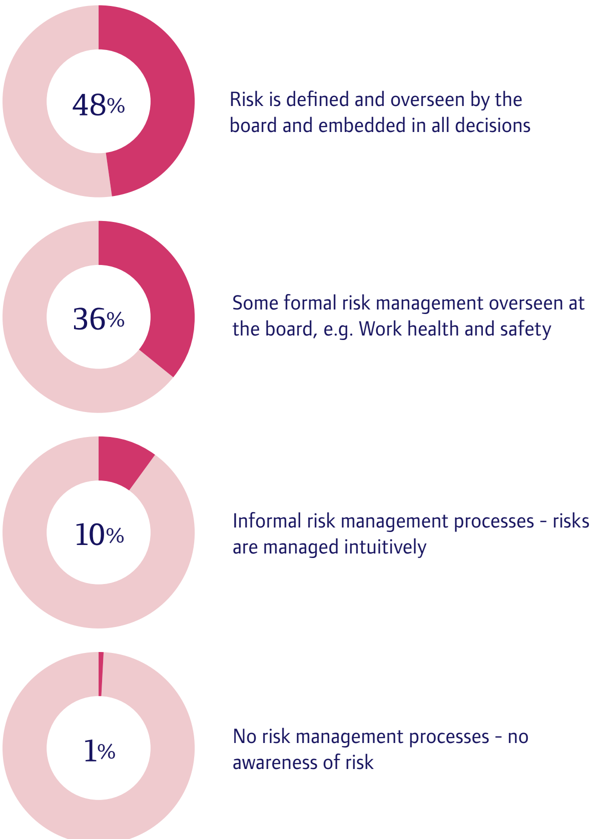
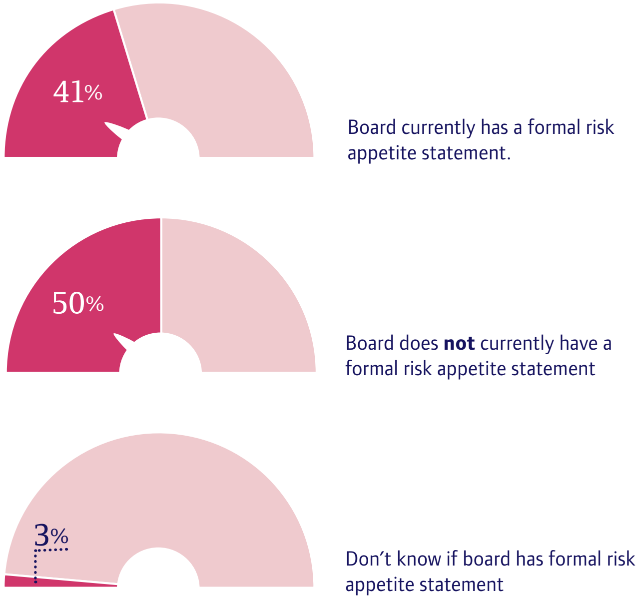


Fig 8: Does the board currently have a formal statement that describes risk appetite?
n = 1,298



Although many NFP directors (48%) reported that risk is defined and overseen by the board, there are a large number that are not taking a formal and systematic approach to managing risk.

Half of directors said their NFP had no formal risk management statement, while 36 per cent said there was only some formal risk management oversight at board level relating to discrete risk factors, such as work health and safety. A further 11 per cent of directors said their NFPs had only informal risk management processes, or no risk management processes at all.

"Significant financial risk has been taken but is being well managed. Other risks are less significant but are not well identified or managed," said one director in the focus groups.

As would be expected, larger organisations tend to have a more sophisticated approach to risk management. Seventy-one per cent of directors of organisations with over $50m in annual revenue said that risk is defined and overseen by the board and they have a fully-developed risk management process, compared to only 36 per cent with less than $5m in revenue.

It appears that work needs to be done across the sector to help smaller organisations and their boards define, identify and mitigate risk. "I think we struggle to define risk effectively to guide management," commented one director of a small NFP.

Directors of larger organisations, particularly those working in complex operational environments, described sophisticated risk management policies, including formal risk appetite statements, expansive risk management frameworks, as well as highly-developed strategies for mitigation.

"We identify risks and monitor compliance through a risk committee that meets around every five weeks. A risk management matrix is used and reported to the board," said one director.

Unsurprisingly, the survey found that formal risk management processes are correlated with higher levels of risk taking at NFPs. This could be because organisations that take higher levels of risk also need to develop more sophisticated risk management practices, or it could be that formal risk management practices embolden directors to accept greater risks.

Either way, boards implementing more thorough and systematic risk management statements can only be beneficial for the sector, either allowing organisations to move to a more appropriate level of risk, or to more effectively manage the risks inherent in everyday operation.

Questions
FOR DIRECTORS

- Are there appropriate policies and procedures in place to enable effective oversight and management of risks?
- Do we understand the organisation's headline risks and the steps taken to mitigate them?
- Do we devote time in our agenda to consider risks?
- Have we discussed and articulated its risk appetite?
- How frequently do we need to review our risk appetite statement?
- How do we know if we are managing risk effectively?
- Has management designed and implemented systems to give effect to policies and procedures endorsed by the board?
- Do we have access to adequate experience and expertise to support risk management?
- Does our risk reporting highlight 'red flags'?
- Do we need a risk committee?

3.

Achieving financial sustainability

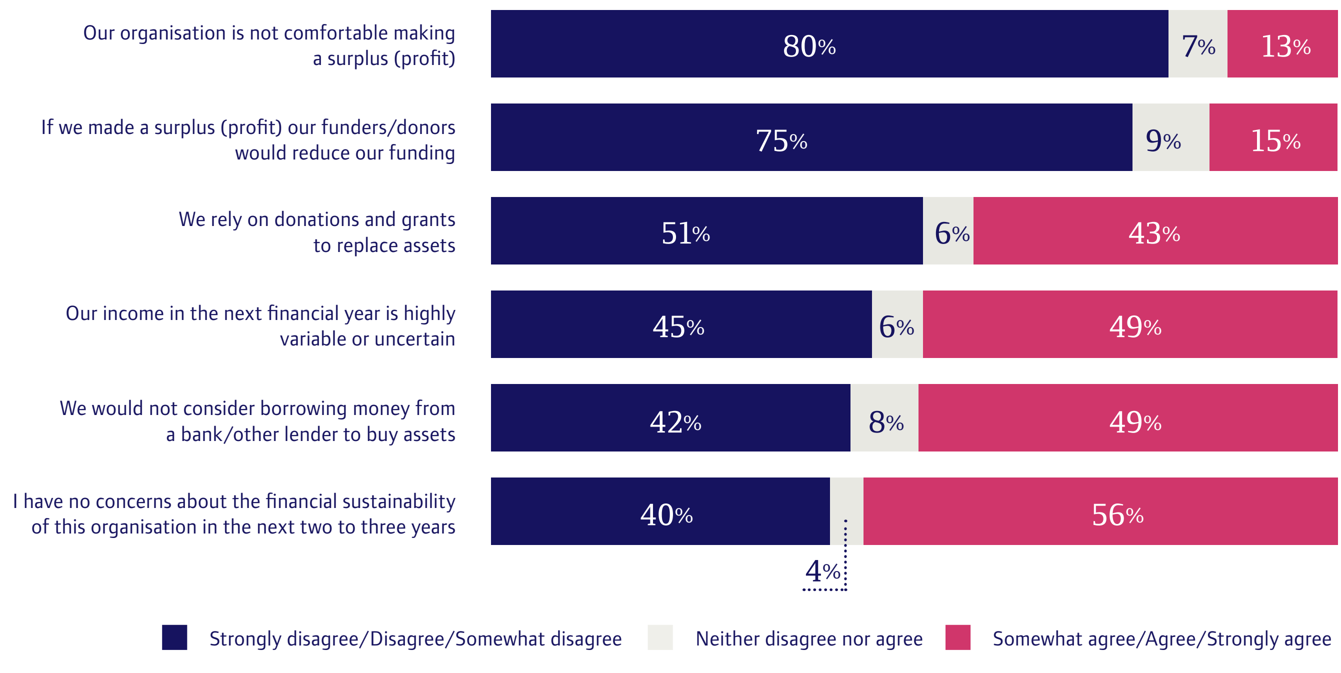
Last year's study challenged perceptions about the financial strength of NFPs. The prevailing view is that NFPs operate in a constant state of financial distress. However, the AICD's research showed that many NFPs were not only surviving but thriving – they were achieving their missions and creating organisations that were financially strong in the process.

Although the findings of the study revealed that financial management of NFPs was sound on balance, the long-term outlook for the financial performance of the sector was less optimistic. Many NFPs reported profit margins insufficient to ensure long-term survival, let alone to approach the challenges of the future from a position of financial strength.

Achieving financial sustainability is consistently reported as one of the main challenges of NFPs and therefore we revisited the themes of last year's study around financial strength.

Misunderstanding around profit persists

Fig 9: Attitude statements on financial performance
n = 1,336



The 2016 study found that there was widespread misunderstanding in the sector about the importance of profit for NFPs. Many directors in our focus groups expressed misgivings about the appropriateness of NFPs making a profit, or had not even considered it as an objective at all. “If we made a profit, we would have to give the money back,” said one director in the 2016 focus groups.

The 2017 study has found that there is still more work to do to change attitudes in the sector around profit. Just as in 2016, 15 per cent of directors said funders/donors would reduce funding if their NFP made a profit, while 13 per cent of directors said their organisation is not comfortable making a profit.

The 2017 results underline that it is important for the sector to continue to have a conversation about profit. At the launch of the 2016 study, Australian Charities and Not-for-profit Commission Commissioner Susan Pascoe AM FAICD said: “Profit is not a dirty word.” As a sector, we must accept that making profit is essential to building the financial strength needed to achieve our missions now and into the future.

Nearly half of directors (49 per cent) continue to report that their organisation’s income for the next financial year is highly variable or uncertain. It is prudent that boards make sure that they are building their organisation’s reserves in good times to be able to withstand any downturns in their income.

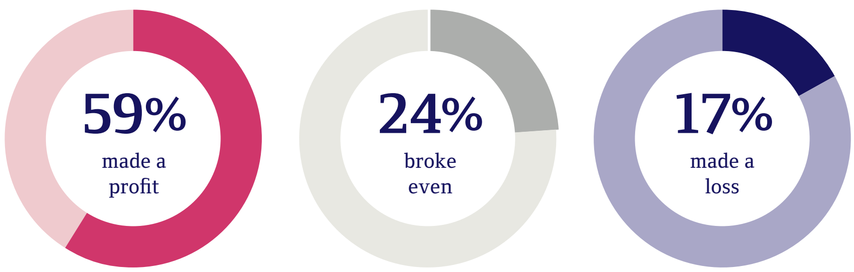
“Profit is not a dirty word.”

Despite the large numbers of directors reporting that their organisation’s income is highly uncertain, more than half (56 per cent) also said they had no concerns about the financial sustainability of their organisation over the next two to three years. This inconsistency, also observed in last year’s study, suggests that some directors may underestimate the urgency of their financial situation. Nearly half (43 per cent) also say that they rely on donations and grants to replace assets, an indicator that the organisation may not be sustainable on its own.

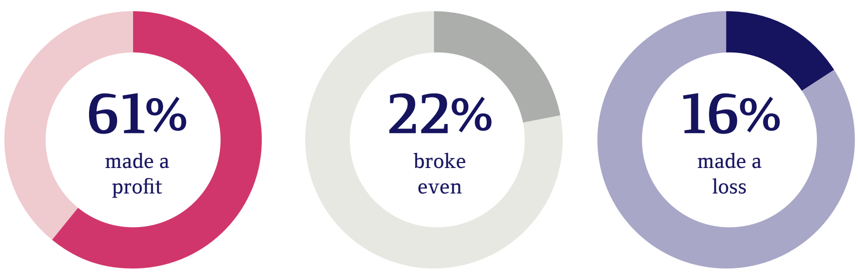
Are NFPs making enough profit for long-term survival?

Fig 10: 2016 current year profitability vs 2017 current year profitability

2016 n = 1,342



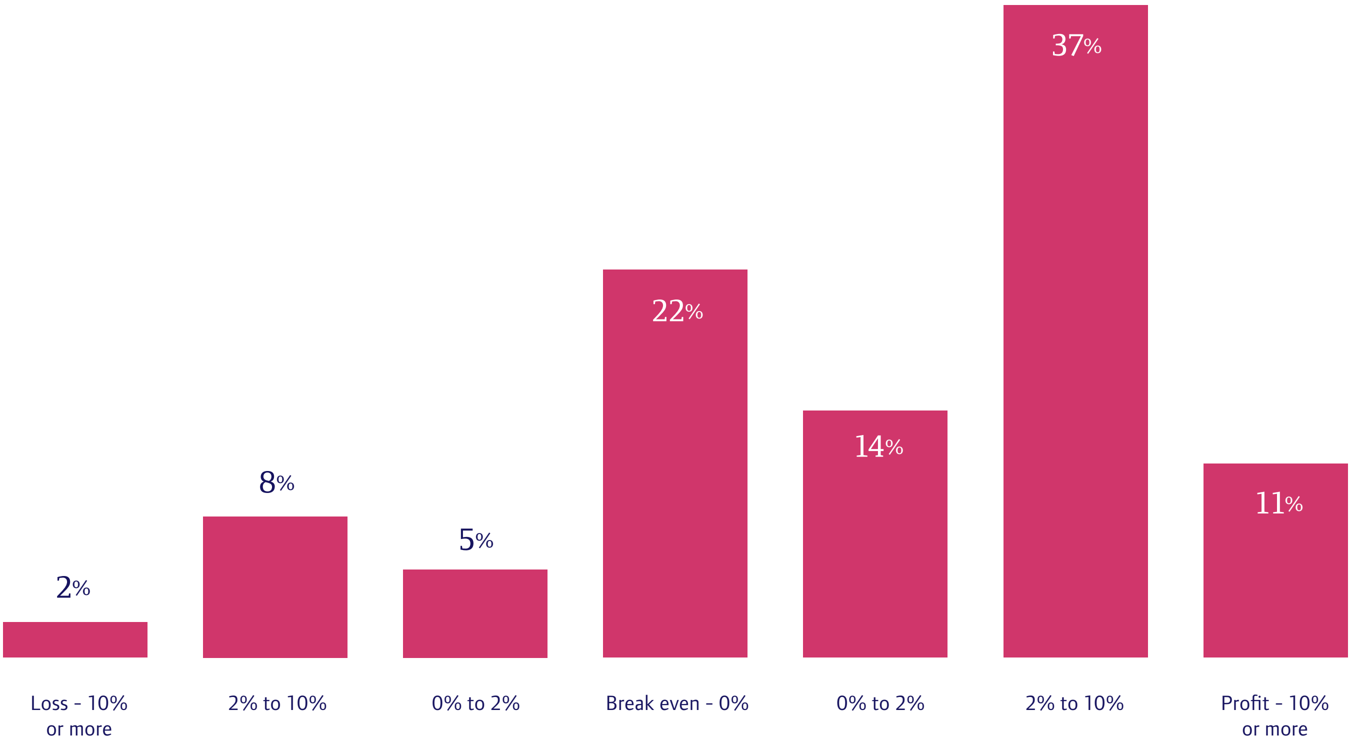
2017 n = 1,358



An NFP is **not** an organisation that cannot make a profit. NFPs can and should make a profit to ensure their long-term sustainability and financial strength. ‘Not-for-profit’ status isn’t about profit at all, but about purpose and how profits are used.

Any profit made by an NFP must be applied towards its purpose, rather than distributed for the private benefit of the people involved.

Fig 11: Profit margin current year 2017
2017 n = 1,348



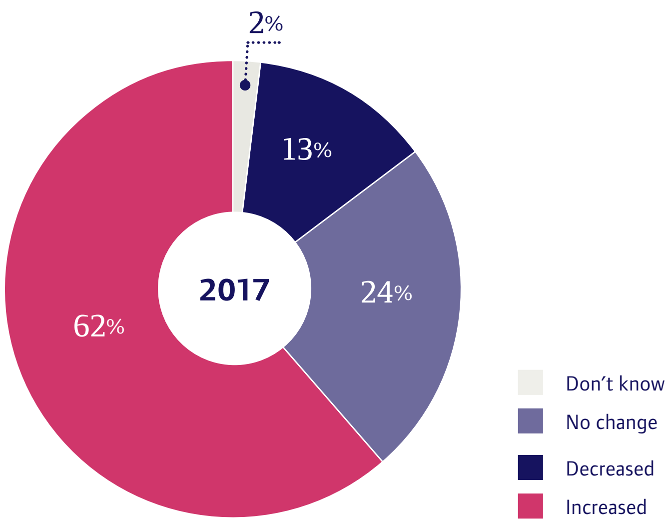
Generally an NFP must make a profit over the long-term in order to survive. While drawing down on reserves can allow an NFP to absorb a loss in a single year, consistent losses over a period of time may be an indicator that an organisation is heading towards insolvency.

The proportion of directors reporting their NFP made a profit in the last year stayed consistent compared with 2016 (roughly 60 per cent) while those reporting a loss also stayed steady (roughly 15 per cent).

The level of profit reported by around half of directors for their NFPs falls below the level likely to be required for long-term survival.

However, of those that made a profit, a quarter recorded slender margins of zero to two per cent – which is lower than inflation. After aggregating the organisations that made a deficit, with the 22 per cent breaking even and those with margins below inflation, the level of profit reported by around half of directors for their NFPs falls below the level likely to be required for long-term survival.

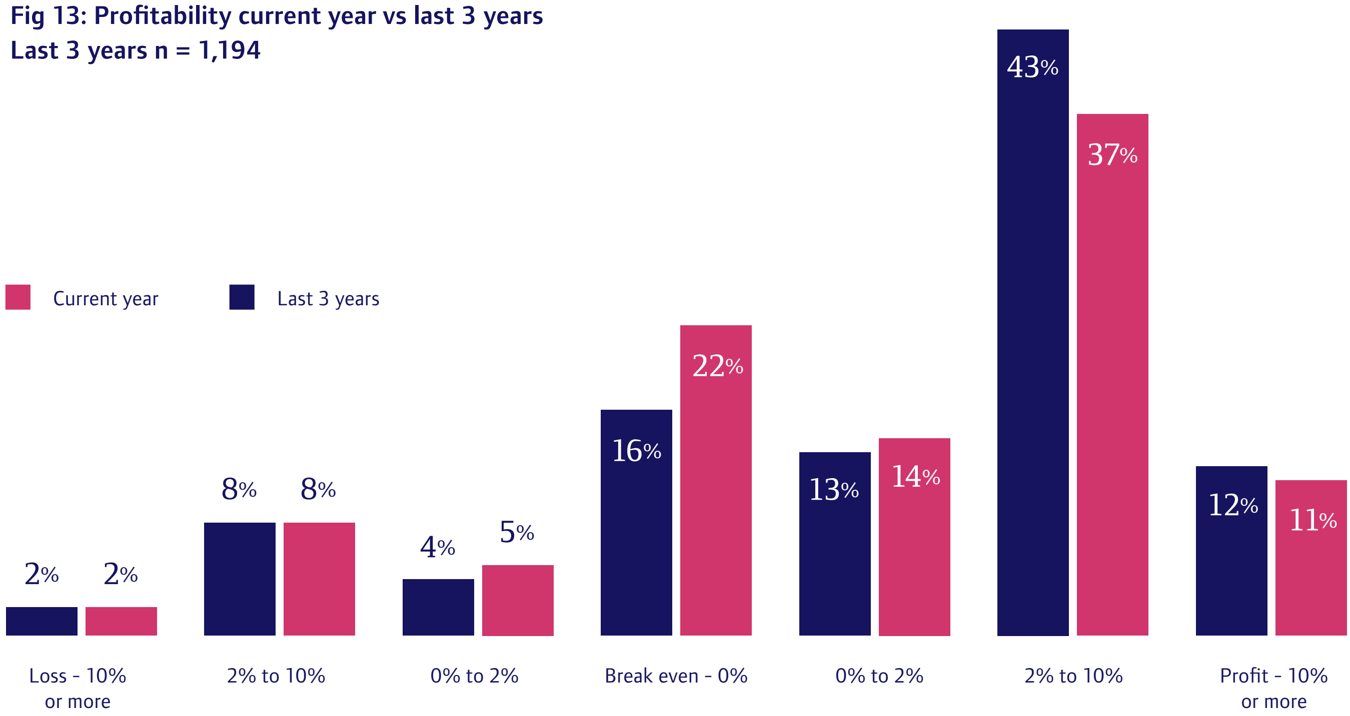
Fig 12: Change in net assets 2017
n = 1,358



Of the 62 per cent of directors who said their NFPs increased net assets in the previous year, 30 per cent reported their NFP made a profit of 10 per cent or more. Over a quarter (26 per cent) of directors who reported a reduction in net assets also said their NFP made a loss of 10 per cent or more.

It is clear that some NFPs are doing well in terms of profitability with one quarter reporting margins greater than 5 per cent.

Fig 13: Profitability current year vs last 3 years
Last 3 years n = 1,194



While the levels of profit recorded this year are roughly the same as last year, there has been some deterioration in levels of profitability over the last three years. The proportion of directors reporting average profit margins of more than 2 per cent, the bare minimum required to keep up with inflation, was a little under 50 per cent for 2017, down from 55 per cent for the last three years. While this may be an isolated result, rather than a trend, it will be important to monitor profit margins across the sector to ensure the ongoing financial strength on which the sustainability of the sector depends.

While the levels of profit recorded this year are roughly the same as last year, there has been some deterioration in levels of profitability over the last three years.

Questions
FOR DIRECTORS

- Have we compared the NFP's profit margin with other similar organisations?
- Are we pursuing a financial strategy that will prepare it for the future?
- Are our assets being leveraged to achieve our mission? What is the target for return on assets?
- Are our reserves sufficient to weather any downturn in revenue or cost increases?
- Is our profit target realistic and appropriate to support our organisation's short, medium and long-term needs?
- Have we communicated our financial strategy to members, supporters, donors and funders?
- What is our board's attitude toward financial performance? Is it appropriate?
- Is the board's attitude toward investment risk appropriate? Is it defined and understood by all board members?

4.

Reputation: an invaluable asset taken for granted?

The NFP sector enjoys high levels of trust and confidence among the Australian public. This reputation has been built over many years of acting with standards of high integrity and providing invaluable services to the community. There are few Australians who have not benefited in some way from the work of an NFP. The trust of the community is a hard-won and well-deserved accolade for the sector.

This positive reputation is an invaluable asset. NFPs leverage the public's goodwill to engage with their communities, attract talented staff and volunteers, and – critically – to secure donations, grants and funding to support their work.

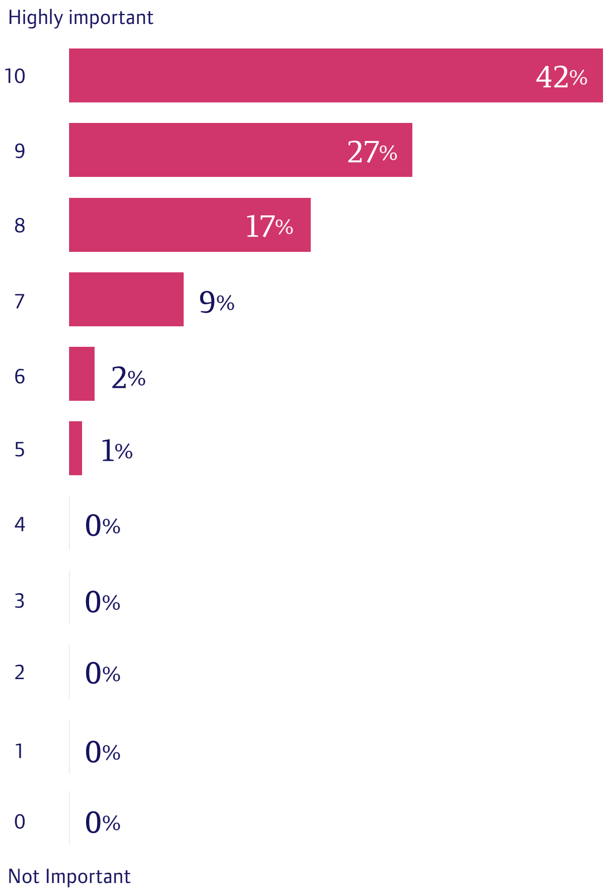
Although the NFP sector has a positive reputation, it is not invulnerable.

Without this precious resource, the work of the sector and the individual organisations within it could be seriously undermined. This was highlighted by one director in the focus groups, who reflected: "Our reputation externally as well as what our members say to potential funders critically drives our sponsorship income, which is 30 per cent of all receipts. The quality of the endorsement from members has declined… [this] undermines funding receipts and creates a vicious downward spiral in potential solutions."

Managing an organisation's reputational risk is possibly more of a challenge than it has ever been. Adverse commentary or criticism can spread rapidly on social media channels, then reverberate through the traditional media. Even smaller NFPs cannot escape public attention when the circumstances are right. The arena of reputational management has been redefined.

"Reputation is a showstopper"

Fig 14: Importance of reputation
n = 1,279

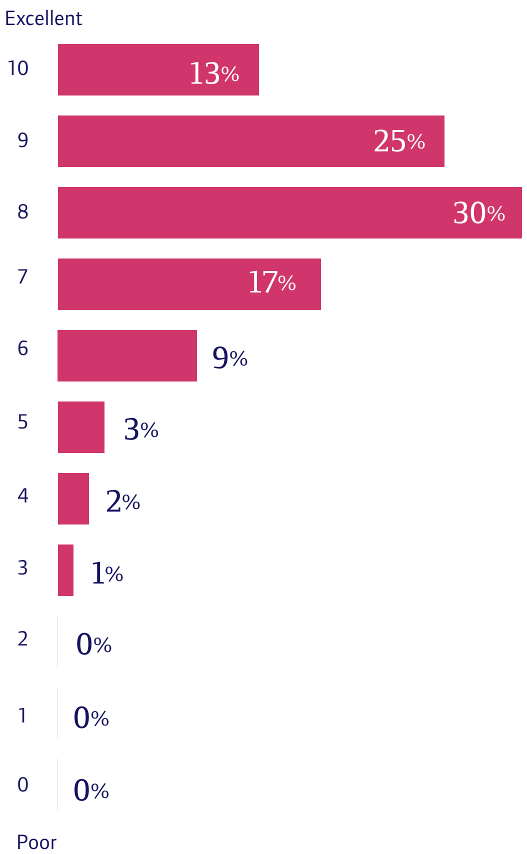


There is near unanimity that reputation is vitally important for NFPs with 97 per cent of directors rating it seven or above in importance on a scale from zero (not important at all) to ten (highly important). This view was echoed by directors in the focus groups with one director commenting that reputation is a "complete showstopper" and adding that their NFP "would cease to function without a sterling reputation".

Although purpose may vary between NFPs, maintaining a good reputation is a fundamental imperative across all segments of the sector. One member of a school board said that their "reputation amongst current and potential parents, students and teachers, and the state authorities is vital". "In medical research, ethics and reputation are critical," commented another director.

Putting reputation on the agenda

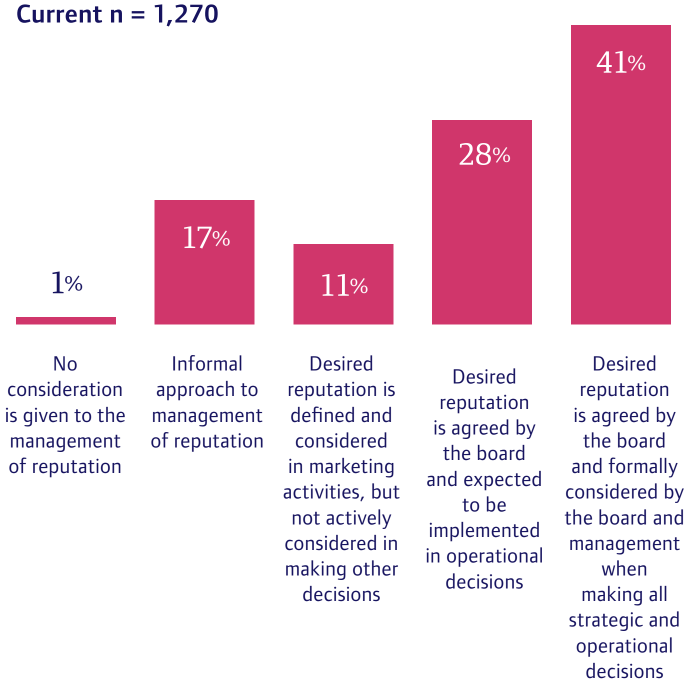
Fig 15: Directors' assessment of NFP reputation
Current n = 1,255



On balance, directors have great confidence in their organisation's reputation. More than two thirds of directors scored their reputation as an eight or above, on a scale of zero (poor) to ten (excellent).

Although directors may have justifiably high opinions of their organisation's reputation and great appreciation for its importance, there is little evidence of a sophisticated approach to quantifying, building or protecting this invaluable asset.

Fig 16: Reputation management
Current n = 1,270



Less than half of directors said desired reputations is agreed by the board and formally considered when making all strategic and operational decisions.

Directors understand the importance of reputation, but its value is not reflected in governance processes.

A further 28 per cent of directors said desired reputation was agreed by the board but only implemented operationally. Nearly a third of directors (29 per cent) only considered reputation in regard to marketing activities, took an informal approach to reputation management, or gave it no consideration at all.

Reputation should be a key strategic consideration, not merely an operational matter. At the very least the board should have turned its mind to issues of reputational management and be satisfied that there are policies and procedures in place to safeguard it. Strategic boards will go a step further and consider how their reputation can be grown and leveraged to achieve their purpose.

The discussions in the focus groups bore out this result from the survey. All directors in the focus groups agreed on the importance of reputation, yet few of their NFPs had taken concrete steps to manage reputation. “Reputation is not seen as a board issue,” said one director. “We are in denial and our opinion of who we are and how we see ourselves drives us perilously close to community and stakeholder perception blindness,” another director stated frankly.

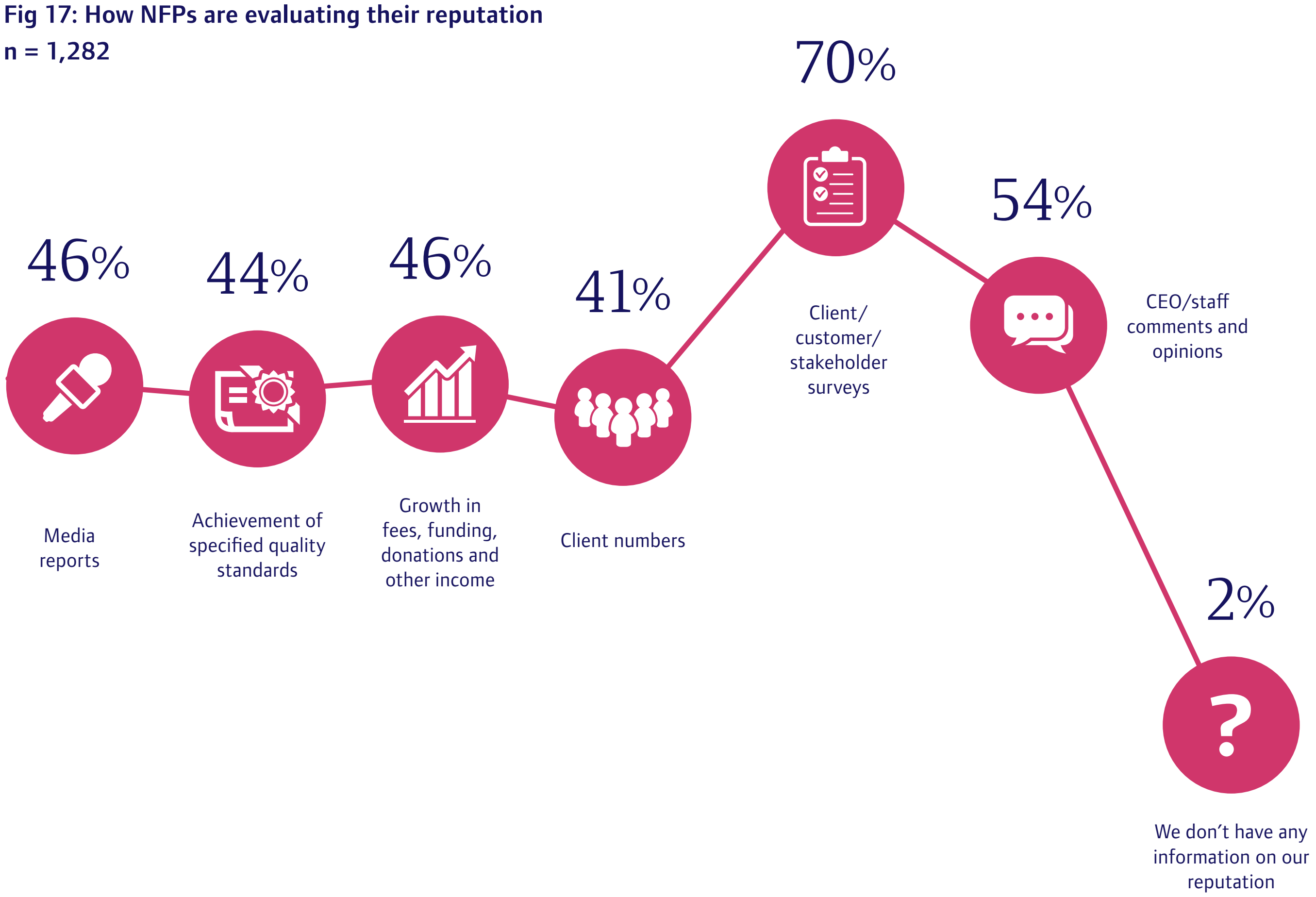
Organisations and boards that are not actively managing their reputation can lose control at critical times. The best time to consider how to protect your reputation is outside a crisis situation. It is prudent to have plans in place that will guide your organisation through challenging situations so that you can focus on responding from a position of confidence in such circumstances. When disaster strikes, the time such plans can buy you is invaluable.

Without a plan in place, at times of crisis the conversation can be controlled by people external to the organisation, some of whom may be malicious. Information and misinformation can spread on social media. Organisations that do not have plans in place will struggle to have their voice cut through the noise.

Evidence from the study suggests that a number of different methods are being used to measure reputation which may or may not be appropriate. CEO and staff comments are the second most utilised method (54 per cent) to evaluate reputation after client/stakeholder surveys (70 per cent).

Other popular methods are growth in fees, funding and donations, and media reports, which for the most part will only serve as lagging indicators of a dip in reputation. Importantly, measures such as this provide little flexibility for boards to take proactive steps to address issues of reputational management.

Fig 17: How NFPs are evaluating their reputation
n = 1,282

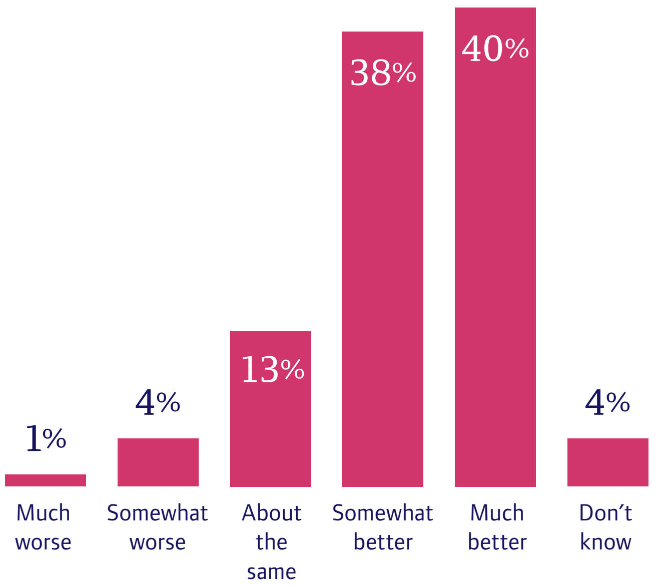


Questions
FOR DIRECTORS

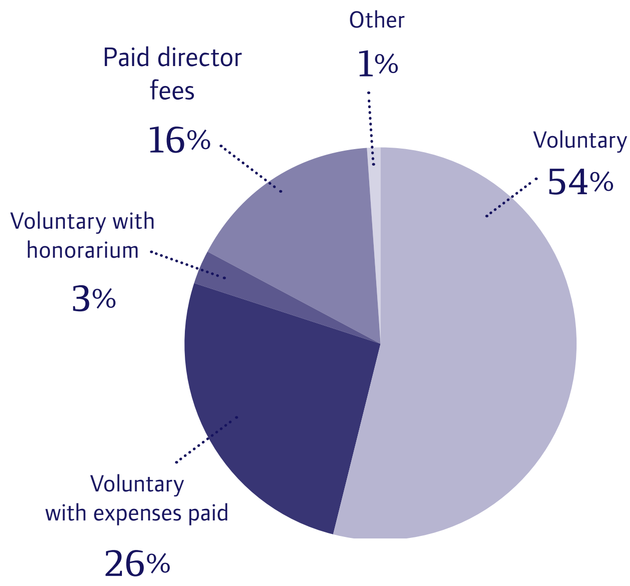
- Have we evaluated our organisation's reputation?
- Do we consider issues of reputation as a dimension of decision-making?
- Have we identified our key stakeholders and current relationships?
- Who are the key influencers on our reputation?
- Do we have a methodology for monitoring changes in our reputation?
- Has the board clearly defined the reputation the NFP should have with clients and external stakeholders?
- Do we have a media and social media policy? Are they communicated and understood by relevant stakeholders?
- Does the organisation have a crisis management and communications plan?
- Is there a periodic assessment by the board as to how the NFP engages with key stakeholders?

Key highlights

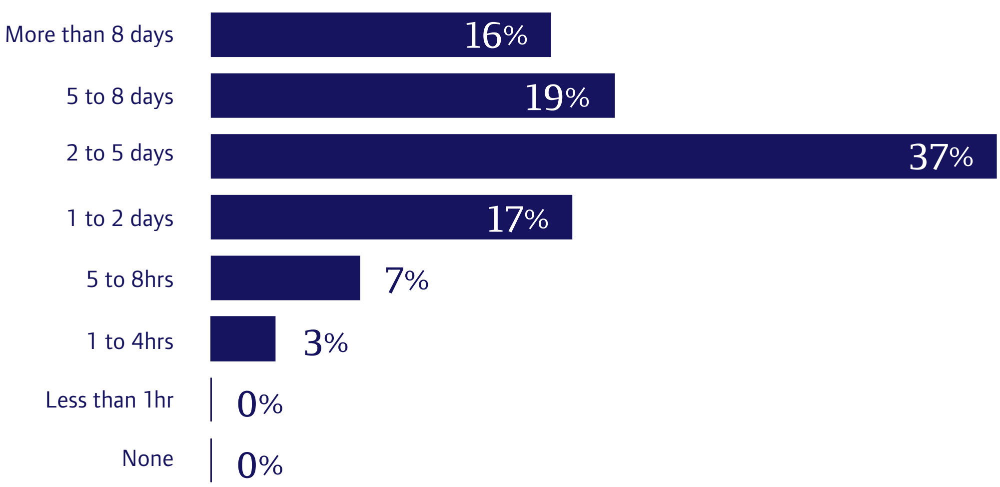
Quality of governance compared with three years ago (n = 1,319)



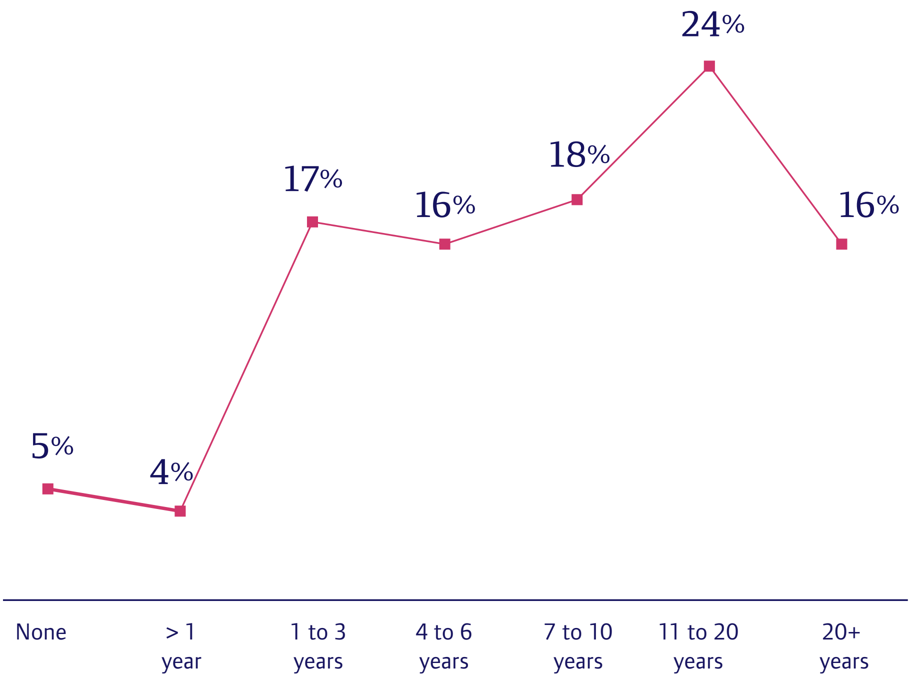
Payment of Directors (n = 1,160)



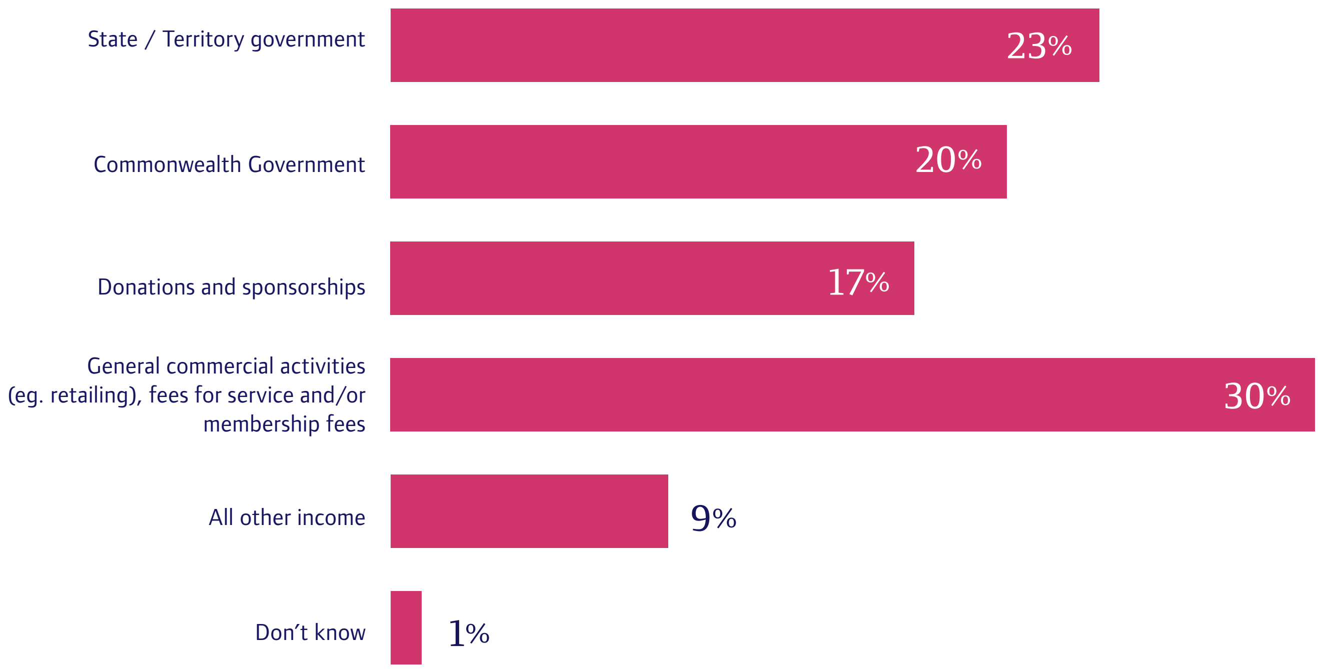
Days/Hours per month on all NFP governance work (n = 642)



Years of experience as non-executive director of NFP
(n = 1,469)



Source of income (mean score)
(n = 1,437)



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	2017
Total sample	**2,190**	**3,210**	**2,976**	**1,822**	**1,928**
NFP income	**1,198**	**2,265**	**2,471**	**1,478**	**1,491**
Under $100k	7%	7%	7%	4%	4%
$100k to $250k	7%	7%	6%	5%	5%
$250k to $500k	7%	8%	8%	7%	6%
$500k to $1m	6%	7%	8%	7%	7%
$1m to $2m	8%	11%	10%	12%	12%
$2m to $5m	15%	15%	16%	16%	16%
$5m to $10m	11%	11%	11%	12%	13%
$10m to $20m	12%	11%	12%	11%	12%
$20m to $50m	15%	11%	10%	12%	11%
$50m+	12%	12%	11%	14%	13%
Don't know	0%	1%	0%	1%	1%
Main sector of operations	**1,199**	**2,240**	**2,475**	**1,500**	**1,504**
Culture and Recreation. Includes Arts	10%	11%	15%	9%	10%
Education and Research. Includes primary, secondary, higher and vocational education	19%	17%	14%	14%	14%
Health. 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%	18%

	2013	2014	2015	2016	2017
Social services and Aged care. Excludes Disability services.	N/C	N/C	N/C	N/C	14%
Disability services					14%
Environment. Includes animal protection	3%	3%	2%	4%	3%
Development and Housing. Includes economic and social and community development in communities, housing assistance, employment and training	3%	3%	5%	4%	4%
Law, Advocacy and Politics	1%	1%	2%	2%	2%
Philanthropic intermediaries and Voluntarism promotion. Includes fund raising, grant making foundations and supporting volunteering	3%	2%	2%	3%	2%
International activities. Includes promotion of social and economic development, cultural exchange, international disaster and relief, human rights and peace organisations overseas	2%	2%	3%	3%	3%
Religion. Includes congregations and associations of congregations	2%	2%	2%	2%	2%
Business and Professional associations. Includes labour unions	8%	8%	7%	6%	6%
Not elsewhere classified	15%	16%	10%	8%	9%

NFP Structure	**1,193**	**2,261**	**2,477**	**1,195**	**1,445**
Company Limited by Guarantee	44%	44%	47%	51%	51%
Incorporated Association	34%	38%	38%	34%	35%
Unincorporated Association	2%	3%	3%	3%	2%
Body Corporate	1%	2%	2%	1%	1%
Cooperative	1%	N/C	N/C	1%	0%
Organisation established by Act of Parliament or Royal Charter	8%	N/C	N/C	6%	6%
University Senate/Council/Board	7%	3%	2%	1%	1%
Don’t know		1%	2%	1%	1%
Other	4%	9%	7%	0%	2%

Charitable status	**1,100**	**2,100**	**2,305**	**1,370**	**1,442**
Registered charity	45%	49%	58%	70%	70%

	2013	2014	2015	2016	2017
Source of Income (mean score)	**1,198**	**1,642**	**2,482**	**1,437**	**1,458**
State/Territory Government	17%	19%	18%	19%	23%
Commonwealth Government	21%	20%	18%	21%	20%
Donations (individual or corporate)	8%	11%	12%	12%	17%
Sponsorships	7%	7%	8%	4%	
Fees for service (e.g. school fees, service fees, insurance premiums)	13%	12%	12%	14%	29%
Membership fees or levies	12%	10%	14%	11%	
General commercial activities (e.g. retailing, consulting services)	11%	10%	8%	8%	
Other	2%	2%	3%	4%	9%
Don't know	1%	1%	1%	1%	1%
Overall rating of effectiveness (7 point Likert)					**1,419**
Highly ineffective	N/C	N/C	N/C	N/C	4%
Mostly ineffective					3%
Somewhat ineffective					2%
Neither in effective nor effective					1%
Somewhat effective					13%
Mostly effective					42%
Highly effective					35%
Don't know					0%
Quality of governance compared with three years ago	**N/C**	**1,911**	**2,373**	**1,195**	**1,319**
Much worse		0%	0%	0%	1%
Somewhat worse		2%	2%	2%	4%
About the same		12%	13%	13%	13%
Somewhat better		37%	33%	37%	38%
Much better		49%	44%	43%	40%
Don't know		9%	8%	4%	4%

	2013	2014	2015	2016	2017
Hours per month on all NFP governance work	**1,110**	**1,108**	**1,201**	**632**	**642**
None	0%	0%	0%	0%	0%
Less than 1 hr	0%	0%	0%	0%	0%
1 to 4 hrs (up to half a day)	5%	2%	3%	4%	3%
5 to 8 hrs (1/2 to 1 day)	15%	9%	11%	8%	7%
1 to 2 days (9 to 16 hrs)	23%	23%	19%	18%	18%
2 to 5 days (17 to 40 hrs)	33%	33%	33%	31%	37%
5 to 8 days (41 to 64 hrs)	13%	16%	19%	19%	19%
More than 8 days (64 hrs+)	11%	17%	14%	20%	16%
Hours per month on this NFP	**1,010**	**2,383**	**2,601**	**1,038**	**1,064**
None	0%	0%	1%	0%	0%
Less than 1 hr	0%	1%	0%	0%	0%
1 to 4 hrs (up to half a day)	8%	10%	9%	6%	7%
5 to 8 hrs (1/2 to 1 day)	24%	20%	20%	17%	17%
1 to 2 days (9 to 16 hrs)	27%	31%	28%	27%	28%
2 to 5 days (17 to 40 hrs)	28%	25%	26%	32%	30%
5 to 8 days (41 to 64 hrs)	8%	9%	9%	11%	11%
More than 8 days (64 hrs+)	5%	5%	7%	8%	7%
Payment of directors	**1,007**	**2,298**	**2,592**	**1,160**	**1,274**
Voluntary	55%	58%	59%	56%	54%
Voluntary with expenses paid	20%	23%	22%	24%	26%
Voluntary with honorarium	5%	30%	4%	3%	16%
Paid directors fees	19%	15%	13%	15%	3%
Other (specify)	1%	1%	1%	2%	1%

	2013	2014	2015	2016	2017
Merger data		**1,958**	**2,259**	**1,139**	**1,272**
Discussed merger		32%	32%	35%	38%
Currently undertaking a merger	N/C		7%	8%	7%
Completed a merger in the last 12 months		N/C	7%	6%	6%
Discussed winding-up			8%	7%	9%
Likelihood to merge in the next two years (7 point Likert)	N/C	N/C	N/C	N/C	**479**
Less than 10%					22%
10% to 25%					14%
25% to less than 50%					13%
About 50%					16%
More than 50% to 75%	N/C	N/C	N/C	N/C	15%
Between 75% and 90%					11%
More than 90%					8%
Don't know					1%
Gender	**1,859**	**2,479**	**2,439**	**1,234**	**1,511**
Male	70%	63%	62%	61%	57%
Female	30%	37%	38%	39%	42%
Prefer not to answer	N/C	N/C	N/C	N/C	1%
Age	**1,857**	**2,485**	**2,439**	**1,304**	**1,509**
18 to 29	N/C	N/C	N/C	N/C	1%
30 to 39	5%	5%	4%	6%	4%
40 to 49	23%	22%	19%	18%	20%
50 - 59	41%	41%	40%	40%	38%
60- 69	26%	27%	30%	29%	30%
70+	5%	5%	6%	6%	7%

	2013	2014	2015	2016	2017
Years experience as non executive director of NFP	**1,829**	**2,483**	**2,392**	**1,259**	**1,459**
None	26%	9%	1%	6%	5%
Less than 1 year	3%	3%	4%	4%	4%
1 to 3 years	13%	16%	17%	14%	17%
4 to 6 years	15%	18%	20%	17%	16%
7 to 10 years	15%	19%	20%	18%	18%
11 to 20 years	17%	21%	23%	24%	24%
More than 20 years	10%	13%	15%	17%	16%
Years experience as non executive director of For profit	**1,794**	**2,455**	**2,345**	**1,229**	**1,445**
None	38%	46%	44%	46%	49%
Less than 1 year	3%	2%	2%	2%	2%
1 to 3 years	10%	8%	10%	8%	9%
4 to 6 years	11%	9%	9%	8%	8%
7 to 10 years	11%	9%	9%	9%	8%
11 to 20 years	15%	14%	13%	12%	11%
More than 20 years	12%	12%	14%	15%	13%
Location	**1,864**	**2,480**	**2,440**	**1,299**	**1,511**
New South Wales	27%	27%	28%	32%	33%
Victoria	25%	29%	28%	25%	27%
Queensland	16%	15%	15%	15%	13%
Western Australia	13%	11%	12%	11%	10%
South Australia	7%	8%	7%	7%	7%
ACT	4%	3%	4%	6%	4%
Tasmania	3%	4%	4%	3%	3%
Northern Territory	1%	1%	1%	1%	2%
Outside Australia	3%	1%	1%	0%	1%

The research method and sample

Research method

The 2017 study involved:

- Nine Focus groups attended by more than 50 directors. Three groups were held with directors of disability service organisations and two of directors of organisations operating internationally. The remaining four groups were held with directors from a range of NFP sectors and covered general governance issues.
- An online survey of AICD members (distributed by AICD) and senior executives and directors of organisations that are members of National Disability Services (distributed by National Disability Services). We thank NDS and their members for their generous support of the study. The survey was available to respondents between 7 June and 9 May 2017.

The survey sample

A total of 1,928 people responded to the survey. Of these, 1,612 were current directors or senior executives of NFP organisations and 191 were directors or senior executives of organisations.

As in previous years, the sample includes a significantly higher proportion of respondents who are directors of larger organisations and therefore reflects the views of these directors and not directors of the NFP sector more broadly. There is no data available on the distribution of NFP organisations by size, but data from the Australian Charities and Not-for-profits Commission provides some comparison of our sample with the population of charities for comparison. Charities are a subset of NFP organisations.

Focus groups

Sydney	Perth	Adelaide
General	General	General
International	Disability	Disability
Alice Springs	**Melbourne**	
General	Disability	
	International	

Size categories

	Income last financial year	Our respondents	ACNC Charities data[1]
Very small	Less than $250k	9%	74.8%
Small	>$250k to $1m	13%	12.6%
Medium	>$1m to $5m	28%	8.1%
Large	>$5m to $20m	25%	3.2%
Very large	More than $20m	25%	1.2%

Thank you to National Disability Services for supporting the study by distributing the survey to their members.

1 Calculated from data provided by ACNC 2015 Annual information Statement data 22 August 2017

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 40,000 includes directors and senior leaders from business, government and the not-for-profit sectors.

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BaxterLawley conducted the 2017 NFP Governance and Performance Study on behalf of AICD.

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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 2017 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.

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