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Voluntary Governance (VG) in the Not-for-Profit Sector: The Model for Retention and Recruitment of Boards of Directors

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“Voluntary Governance” (VG) in the Not-For-Profit Sector: The Model for Retention and Recruitment of Boards of Directors

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Abstract This research seeks to explore the current type of Voluntary Governance (VG) mechanisms used to monitor and control Not-For-Profit (NFP) entities at the Board of Directors (BOD) level. It uses case study analysis to investigate the Model rules for NFP Directors. The questions explore the Board and governance mechanisms for NFPs, particularly focusing on the value added by Voluntary Board members, to make recommendations for reporting of Voluntary Governance by NFPs. The Global Financial Crisis demonstrated the importance of Accountability, Transparency and good Corporate Governance of all types of organizations be they Not-for-Profit (NFP) or for-profit. This research demonstrates the obligations of Voluntary Directors in terms of legislation, common law duties and equitable fiduciary duties in relation to governance, social responsibility, transparency and risk management, particularly in a sector that contributes so much to the global economies in terms of employment and GDP [1], [2].

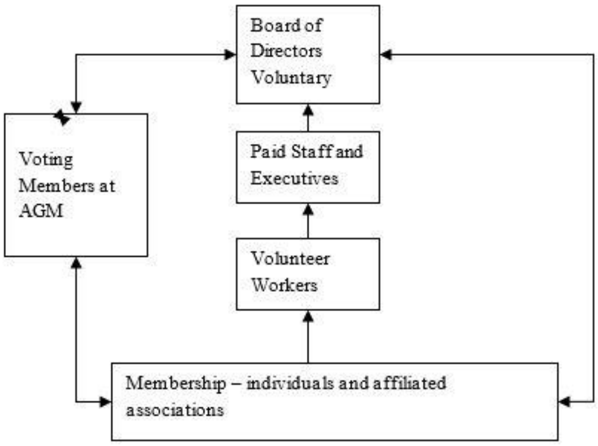
Keywords Voluntary Governance, Social Responsibility.

I. INTRODUCION

This research reports on the use of the concept of voluntary Board members in the not-for-profit (NFP) sector, in the Australian context, otherwise known as “Voluntary Governance” (VG). As NFP entities are a significant contributor to social responsibility, as well as employment and GDP [1], [2], it is important that Directors are aware of their responsibilities which at times are higher than that of paid board members [3]. As voluntary directors in the NFP sector, Directors are not only bound by Corporations Law 2001, but as part of the Federal Government rollout of the new Australian Charity and Not-For-Profits Commission (ACNC), the Commission Bill of 2012 adds to the current corporate law liabilities of directors.

The Australian Charity and Not-For-Profits Commission Bill of 2012, places “personal liabilities” on volunteer Directors, over and above that of the current corporate law. It effectively states that as the directors are volunteers they do not need to be protected against the corporate veil. The Australian Institute of Company Directors stated that Australia should avoid becoming “the first country in the world to make it more onerous for directors to sit on a NFP Board” [3]. This is also echoed by the Chartered Secretaries of Australia who state that the Bill imposed “obligations, liabilities and offences” for those responsible for NFP entities. Figure 1 demonstrates the structure of a not-for-profit entity, showing the difference between a company, who would have shareholders and a CEO.

Figure1: Not-for-profit structure



In Australia the importance of directors and disclosure in not-for-profit entities was recognised in the 2008 Senate Standing Committee on Economics Report – “Disclosure regimes for Charities and Not for profits Organisations”, which recommended that new disclosure regimes should include numeric as well as narrative reporting, acknowledging that stakeholders need more information than not-for-profits were currently giving. Under this legal setting, it is understood that the formal director’s duties are just as important in corporations and not-for-profit entities, and that corporate governance as a mechanism is an important part of the running of such entities as it is for other businesses. It is against this backdrop that this research is focused, firstly on the use of corporate governance by not-for-profit entities, and then specifically on the formalisation of directors/committee members duties within the organisations. The concept then of Voluntary Governance (VG) is designed and explored, using a previously identified GOLDEN model [4]. Firstly however, the definitions of NFPs on an international level are shown in table 1.

Table 1: Definitions of NFPs

An entity whose principal objective it not the generation of profit [5]. Non-profit institutions (NPIs) have the following characteristics: they are not-for-profit and non-profit-distributing, they are institutionally separate from government [2].
Guidance criteria of an NFP [6].
Determined by its primary objective with key and supporting indicators [7]. Non-business organisations [8].

NFP entities contribute up to 8% of GDP in Australia [9], and had in 2010, nearly 5 million volunteers contributing an additional $14.6 billion in unpaid work [10]. With this significant contribution to the economy, the governance and accountability of these organizations needs to be monitored. The recent (Australian) Directors Social Impact Study [10] found that 58% of directors surveyed sat on both NFP and corporate boards, with 89% of respondents indicating that they performed their role on a voluntary basis. Lewis [11] argues that this sector is a growing worldwide phenomenon.

Broadbent and Guthrie [12] state that, "public services are progressively seen by policy makers to be as significant as the commercial sector in the context of wider economic and social development." In their paper they illustrate this by drawing on World Bank documents to show this increased importance. For example, according to BRW [13] there are between 700,000 – 750,000 not-for-profit entities operating in Australia alone. They employ 8.5% of the nation's workforce, and for 2006-2007 reported net assets of A$36.1 billion. During 2004 in Australia, 3.4 million individuals contributed A$5.7 billion to charity, while corporations contributed A$3 million in 2003-2004 [13]. The charitable sector is often taken for granted and yet it contributes more to the Australian GDP than the communications sector and has more employees than the mining sector. "But getting a clear picture of the sector is not so easy. Extraordinarily for a sector that plays such a big economic role, there has never been a complete survey of all its participants [14]. There were 56,894 NFP organisations in Australia registered with the ATO at June 2013. In 2012-13, NFPs accounted for $54,796m or 3.8% of total GVA (Gross Value Added). NFP GDP in 2012-13 is $57,710m. NFPs received income of $107,480m in 2012-13, and held $176b worth of assets. NFPs contribute significantly to employment, accounting for 1,081,900 employed persons and almost 3.9 million volunteers. Volunteers contributed 521 million hours to NFPs, equating to an equivalent of 265,600 full time employed persons. The economic value of these hours was estimated at $17.3b. [2].

II Voluntary Governance (VG)

Management is concerned with organising, planning, controlling, and leading organisations with limited resources to achieve goals [15], but governance also involves the limitation of powers to control and direct, and regulate organisations [16]. Governance is necessary for corporate entities, nation states, associations, clubs, and societies to function legitimately and efficiently for the benefit of those for whose wellbeing they are argued to have been created.

The interest in corporate governance for corporations seems to have peeked over the last twenty years [17,18,19,20,21]. Large corporations appear to have recognised the wisdom of complying with the governance regimes currently in fashion. "The logic is simple: poor corporate governance is viewed as risky, whereas creditors and investors view good governance as a sign of strength in a company" [22]. It is thus no surprise that the Horwarth 2004 Report [23] showed that since 2003 the top 250 listed corporations in Australia had "improved disclosures in relation to code of conduct, & risk management".

Following this, "a good governance structure is then one that selects the most able managers and makes them accountable to investors" [24]. It is interesting to discover a vast array of literature on the application of corporate governance for NFPs, or Voluntary Governance (VG). NFPs contribute towards social capital, and are generally perceived as being networks enjoying social trust, facilitating and coordinating for the mutual benefit of society (Putnam, 1995). NFPs have different structures than *for profit* businesses, insofar as they frequently have the added complexity emerging from paid professionals working with volunteers and being accountable to society. The literature on corporate governance applications in relation to NFPs in particular focuses on the significant differences between for profit entities and charitable organisations.

The survival of a not-for-profit organisation depends on its ability to meet the community need more efficiently and effectively than its competitors. According to Drucker [25] non-profit organisations differ from corporate entities due to their difference in the decision-making structures and processes; that although their management techniques may be similar, fundamentally the governance framework adopted will be different. Others, such as Young [26] Mason [27] as well as Alexander and Weiner [28] agree with Drucker [25] that profit orientated and non-profit organisations will differ in their governance frameworks. A study by Barnes [29a, 29b], showed that a comparison of recommended international governance regimes, indicated that only 5 governance regimes were applicable in the NFP sector as shown in table 2. The regimes included the ASX [30] Good Governance Guidelines, the Combine Code of the United Kingdom [31], the Organisation for Economic Co-operation and Development [32], and United States Sarbanes Oxley [33].

Table 2: Applicable Guidelines Voluntary Governance (VG)

	OECD [32]	SOX [33]	CCUK [31]	ASXGCG [30]
Framework	✓	×	×	✓
Transparency	✓	✓	✓	✓
Stakeholders	✓	×	×	✓
Ethical Decisions	×	×	×	✓
Manage Risk	×	×	×	✓

Based on the above, we can re-classify the above information into four categories as follows:

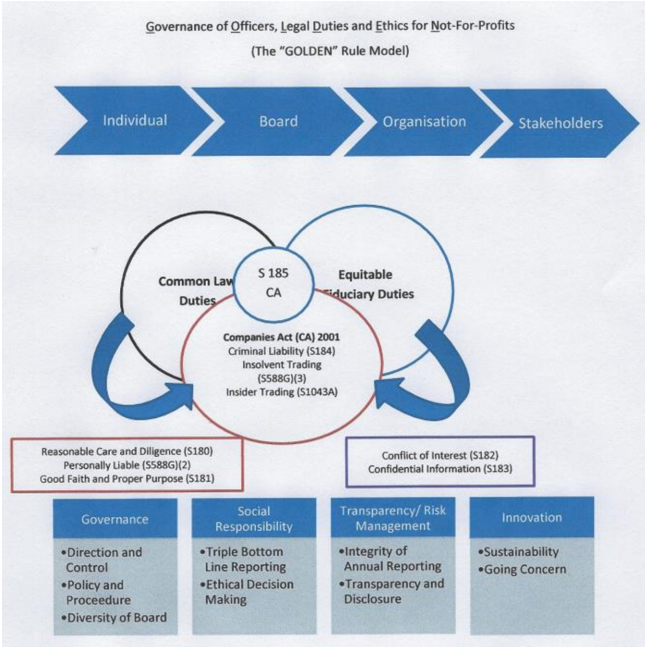
- Governance (Direction and Control, Policy and Procedure, Diversity of Board)
- Social Responsibility (Stakeholders, Triple Bottom Line, Ethical Decision Making)
- Transparency (Integrity of Financial Reporting and Disclosure)
- Risk Management (Sustainability)

III THE GOLDEN RULE MODEL

In the study of ethics, one of the most quoted models is the "golden rule". According to Carroll and Buchholtz [34] the "golden rule" of "Do unto others as you would have them do unto you"[1] is a guide to individuals to act according to what they believe to be true and correct, that is how they would like to be treated, and they feel it is the strongest ethical principle in relation to living and decision making. As can be seen in this illustration the combination of Governance mechanisms, and current Companies Act 2001 rules for Directors (both for-profit and NFP), and current research into SME governance [29] all contribute to a broad based model. These can be categorised as Current legislation, Common Law Duties and Equitable Fiduciary Duties.

A study by Barnes & Howson [4] created the GOLDEN rule model. Using this as a guide then, the GOLDEN rule can be stated in figure 2 for Not-For-Profit Board members. This project examines five Not-For-Profit Enterprises, to assess current governance mechanisms and the proposed "GOLDEN" rule model, to demonstrate Voluntary Governance or VG. Although NFPs are a significant contributor to the economy they are not required by law to demonstrate their adherence to any corporate governance regimes such as the Australian Stock Exchange [31] listing rules.

Figure 2: GOLDEN rule Model



Source: [4].

This underlying concept is that compliance to such rules such as transparent reporting, may encourage further individual donations and corporate contributions, the main income stream of the NFP sector, and allow for survival of the NFP entity in the long term, as this transparency proves to the donor how the funds are utilised within the organisation.

Table 3: Voluntary Governance case studies

Sector	*Services*	*Directors*
Disability	7	6
Aged Care	6	8
Youth Services	5	5
Employment	3	5
Aged Care	3	5

IV METHODOLOGY

The case study methodology [35] will be used to compare and contrast the five case studies. These five case studies were targeted due to convenience sampling, [36] that is they are known to the researcher from business networks. A survey was used to collect the data in a relatively time efficient manner, enabling effective control of the project, facilitating the collection of large amounts of data, and not entailing any *natural* bias [36, 37]. A survey (approved by Newcastle University ethics committee H-2012-0006) was completed by Board members at their monthly meetings, and interviews were conducted with each Chairperson of the various Boards specifically in relation to the GOLDEN rule model.

To contribute to the sustainability of future and present socially responsible NFPs, the primary research problem is two-fold: RP1a:"What are the current Voluntary Governance (VG) mechanisms demonstrated by NFPs"? RP1b:"Would the GOLDEN Rule model assist Boards with their Voluntary

Governance? Specifically the research problems asks the following: ***Research Question 1**: **Do Directors exhibit Voluntary Governance? Research Question 2: Would the Voluntary Governance Board benefit from the GOLDEN rule model?***

V. DATA ANALYSIS

As part of the study, this research targeted five Not-For-Profit, multi-service organisations, focusing on the current Board of directors. The organisations were from the following, with a good mixture of gender equity as shown in table 4:

Table 4: Demographic Information

Case #	Industry Sector	Location	# of Board	Male	Female
A	Disabilit y	NSW	6	3	3
B	Palliative Care	QLD	8	4	4
C	Youth Services	NSW	5	3	2
D	Employ ment	NSW	5	5	0
E	Aged Care	NSW	5	3	2
Total			29 100%	18 62%	11 38%

Research Question 1**: **Do Directors exhibit Voluntary Governance (VG)?

In order to answer this question, the survey administered to the Boards asked specific questions in relation to 1) Independence 2)Time served on Board 3) Paid Directorships / other directorships and 4) use of sub-committees.

All 29 directors or 100% indicated that they were independent in nature which is taken to mean that there are no "***material***" dealings with the Not-For-Profit Entity, as defined by the Australian Corporate Governance Council on Good Corporate Governance [30] This shows a high level of independence to the organisation by all Board members, which should increase the governance ability of the Board to make good governance decisions that are not influenced by any internal dealings with the entity. This demonstrated good BOD governance.

There is no hard and fast rule in relation to time serviced on a board. Old rules such as the Combined Code initially stated that if an independent Board member served for longer than 10 years, that they would be no longer considered "independent", this was confirmed by the Australian Stock Exchange in its 2003 initial "Good Governance" publication, but was revoked in the 2007 edition. It is up to the Board if there is an expiration date on the determination of "independence" but it should be closely monitored by the Board in its annual peer review.

Participants were then asked how many ***paid*** board directorships they were part of, and 13 of the 29 indicated they had other "paid" Board memberships. It is interesting to note that one Board member held 5 paid directorships, and the other individuals indicated only one other paid board directorship. The members were also asked how many other not for profit directors ships were held. Total NFP directorships held was 41, with several directors indicating 2 or more voluntary directorships were held each. This shows experience beyond the current Board membership, which is a good indicator of "added value" to the Board from the Board member apart from industry experience and educational qualifications.

Of the 29 directors, 12 (41%) indicated they were not a member of any subcommittee, and 17 (59%) indicated they were on a committee, with 4 indicating they were on more than one sub-committee (giving a total of 17 memberships on sub-committees) as shown on table 5. As recommended by the Australian Stock Exchange, the use of sub-committees is a recommended governance mechanism that also provides efficiency to the running of the Board in that decisions can be recommended by the sub-committee to be ratifies by the Board at the formal Board meeting. The Board members who were in the sub-committees also indicated some industry and educational qualifications as shown in table 5.

Table 5: Sub-committee memberships

Number #	*Sub-Committee*
1	Innovation and Investment
2	Expansion
2	Technology
5	Finance and Audit
3	Executive Committee
1	Enterprise Bargaining committee
1	OHS
2	Adhoc informal committee
17	Total

From the above data it appears that NFP boards use independent directors, with experience from serving on boards (both in terms of time and other directorships paid and unpaid) and that NFPs use sub-committees as a governance mechanism. Overall, they are demonstrating good governance mechanisms.

Research Question 2: Would the Voluntary Governance Board benefit from the GOLDEN rule model? Responses from the Chairpersons of each board are shown in table 6.

Table 6: Responses to GOLDEN Model from Chairpersons

Case	**Industry Sector**	**Chairperson Comment on the GOLDEN Rule Model**
A	Disability	"This would be a good tool to give new Board members so they are aware of their obligations as a Director".
B	Palliative Care	"It is a bit complicated, but then so is the role of a Director".

C	Youth Services	“Although I understand its necessity, I would worry it would scare away current or potential Board members”.
D	Employment	“Wow, this is a very clear indicator of the importance of getting the right Board members”.
E	Aged Care	“I firmly believe that the notion of “Voluntary” Board membership is on the way out, the only way to encourage new Board members and to retain current members will be to ***pay*** them. This model confirms that via the personal liability that directors can face”.

The overall response was that although the model is complicated, that it does show very clearly the three obligations of Voluntary Governance (VG) Board members:

I. To themselves, the Boards, the Organisation and Stakeholders
II. Their duties are bound by legislation, including common law duties and equitable fiduciary duties
III. The core competencies of a Director include governance, social responsibility, transparency and risk management.

VI. CONCLUSIONS

It appears that NFPs exhibit good voluntary governance in terms of independence, Board equity and diversity and the use of sub-committees. As the above research data shows, the Boards are made up of a variety of gender, experience and educational qualifications. At present Boards of Directors of NFPs in Australia are not paid Directors fees, however some may receive other payments in kind as an incentive to become a Board member. The GOLDEN rules model clearly demonstrates the enormous obligations imposed on directors, and show the clear personal liability that exposes the current and potential board member, unlike that of the paid directors who are given the benefit of the corporate veil.

With the current changes invoked by the Federal initiative of the Australian Charity and NFP Council (ACNC) and the Bill outlining what appears to be extra liabilities on voluntary Board members, it is imperative that Directors understand their obligations. The GOLDEN rule model outlines these obligations and gives NFP directors the opportunity to ask “if not why not” in terms of their governance obligations, similar to that given to paid directors under the ASX (2014) governance regime. This research suggests that while there appears to be good Voluntary Governance (VG) exhibited by current NFPs Directors, however with more personal liability of individual directors, there will need to be more incentives to encourage future directors. It is therefore recommended that future and current NFP Directors be ***paid*** similar to that of listed companies, to reduce the personal liabilities invoked by the new Bill on voluntary Directors.

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Professor Keith Howson

Keith Howson’s career spans a number of decades starting as a junior accountant in South Africa engaged in the nuts and bolts of maintaining an accounting system. Early internal auditing experience finally grew into a doctoral research program in later years. High school teaching was where it all began with a career path encompassing Zimbabwe, England, Australia and the United States of America. He is an experienced university administrator and a teacher who aims to find a nexus between theory and practice. His research interests focus particularly on the not-for-profit sector and accounting education.