

NOT-FOR-PROFIT GOVERNANCE FOR INTERNATIONAL CHARITIES - THE GOVERNANCE AND ACCOUNTABILITY GAP.

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ABSTRACT

Not-for-Profit (NFP) entities on an International basis play a significant role in world economies in relation to welfare, economic growth and employment (OECD 2009). This paper explores the governance mechanisms used to monitor and control these entities - or a lack there of. The question explored is how much control is exercised by mainly voluntary directors in a sector dominated by time and budgetary constraints. International NFP entities were analysed for their corporate governance in terms of accountability in their annual reports, which also includes analysis of the board of directors. Although not-for-profit entities are a significant contributor to international social responsibility, as well as employment and GDP, this research shows a significant lack of accountability via their annual reports. Although most presented audited financial information, in terms of governance, the information had large gaps, which would be unacceptable at a listing corporation level.

Keywords: Corporate Governance, NFP Governance, Accountability and Transparency.

1.1 INTRODUCTION

Corporate governance is not a new concept, however it is a new concept in terms of its application to not-for-profit (NFP) entities. The recent Global Financial Crisis demonstrated to corporate entities just how important corporate governance is. It is acknowledged that corporate governance structures will differ in terms of size, ownership, power structure and community framework, but that overall corporate governance is good for any business. Definitions have varied from how corporations are controlled, to processes and procedures within the organisation (Owen, 2004). Sir Cadbury defined governance as being "concerned with holding the balance between economic and social goals between individual and communal goals" (Clarke, 2007) - a more appropriate definition for the not-for-profit sector, showing that corporate governance is an

appropriate issue for them.

Laws in relation to corporate entities eg, directors duties apply just as formally in a not-for-profit arena as it does in a private or public company, whether it be listed on a stock exchange or not. For example, most countries have legislation in relation to corporate entities and then a separate act for charities that also specifically state that committee members/officers must not make improper use of their information or their position (eg in Australia there is the Corporations Act 2001 and State Associations Incorporation Acts). Statutory duties may differ for incorporated associations, but rules developed by courts in relation to 'fiduciary duties' still apply. Directors duties then are just as important in a NFP entity as any other business.

1.2 Significance of Research

According to the United Nations (2003, p.3), not-for-profit institutions "constitute a significant and growing economic force in countries throughout the world," and Lewis (2005) argues that this sector is a growing worldwide phenomenon. With this backdrop then, the governance and accountability of these organizations needs to be monitored. Broadbent and Guthrie (2008, p. 130) 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 (2008) 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. They contributed 3.5% to the GDP (ABS 2002). During 2004 in Australia, 3.4 million individuals contributed A\$5.7 billion to charity, while corporations contributed A\$3 million in 2003-2004. 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,' (Parkinson, 2009, p.30).

This paper sets out to examine to what extent a sample of the 247 International NFPs - listed by Wikipedia demonstrated good corporate governance. Their annual reports were reviewed for not only financial information, but also for a corporate governance acknowledgement, and board of director information such as duality of CEO and Chairman

roles, independence and board diversity.

1.3 NFP Governance: The Literature

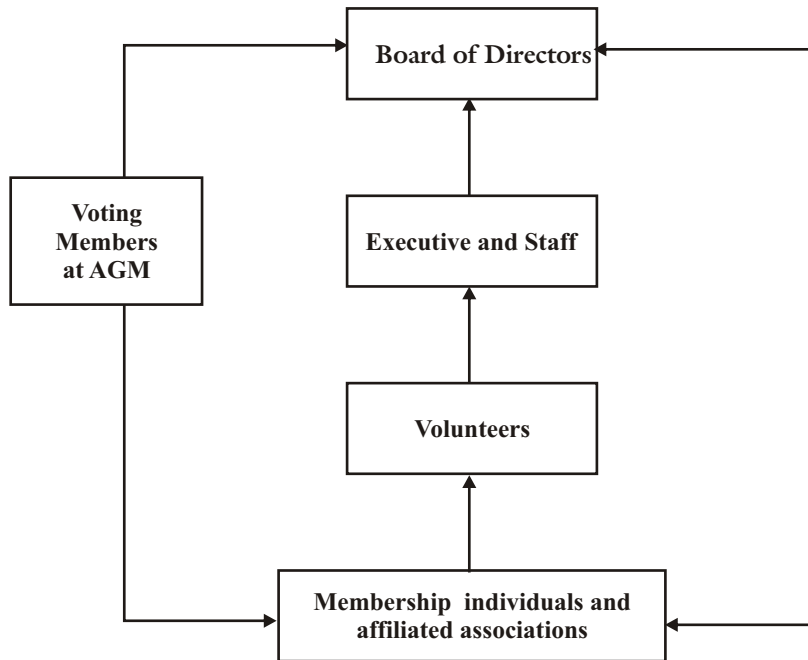
1.3.1 Not-for-Profit Definition and Contribution

NFPs contribute towards social capital, and are generally perceived in the literature 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, because as they frequently have the added complexity resulting 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.

For this reason they argue that NFPs work "under a possibly more diffuse and complex political system than do businesses" (ibid). The survival of a not-for-profit organisation depends on its ability to meet community needs more efficiently and effectively than its competitors. According to Drucker (1990), non-profit organisations differ from corporate entities in their decision-making structures and processes. Although their management techniques may be similar, fundamentally the governance framework adopted will be different. Others, such as Young (1986), Mason (1984) and Alexander and Weiner (1998) agree with Drucker (1990) that profit orientated and not-for-profit organisations will differ in their governance frameworks.

Figure 1. outlines the typical NFP organisational structure.

Figure 1: NFP Organisational Structure



Eveland and Crutchfield (2006) suggest communication strategy will vary depending on the potential donor group that is targeted. For example corporate donors may require reports or requests that focus on their needs, whereas personal donors may not require full financial statements, but instead have approaches that draw on emotional content. Overall however, notes Waters (2007 p,71), "the public is demanding that nonprofit organizations be held accountable for their actions and become more transparent in how donations are being used."

1.3.2 Corporate Governance

"Public trust in boards of directors depends on transparent governance structures and processes and clear accountability to stakeholders" (Gill et al. 2005). Furthermore, the overriding common objective of

governance regimes clearly is to create and maintain an orderly commercial environment for the benefit of the public interest. Corporate governance itself has a long history. Although the term was not used by such early economists as Smith (1776) and Spencer (1862), the idea of running a corporation ethically for the economic benefit of the corporation and, by default, society, underpinned their discussions.

Indeed, Drutman and Cray (2004) noted that corporations were perceived originally to be 'arms of the state'. Viewing corporate America, following the merger and trust movements at the end of the nineteenth century, Berle and Means (1932) popularised the idea that while entrepreneurs were good with ideas, specialist managers should run businesses. Also, because of the emerging corporate structure, professional managers had to be engaged.

Thus, by the early 1930s the notion of the potential problems associated with the separation of ownership from control were firmly embedded in the corporate regulatory literature, as an ultimate consequence of what Bryers (1993) labelled the socialization of capital.

Those potential problems underpin Jenson and Meckling's (1976) discussion of the costs associated with agency monitoring initiatives. The propensity of some agents to focus on personal benefit rather than the best interests of their principals is an ethical minefield and has prompted legislative measures, particularly in the area of corporate governance, to control the practice. Generally shareholders are divorced from control of the company, especially in publically listed companies where management is separate from control.

A definition by Royal Commissioner Neville Owen observed:

"The governance of corporate entities comprehends the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations" (2004, p.101).

1.3.3 Review of International Governance Regimes

The following table shows a comparison of some governance codes on an international level. Arguably there is no one-size-fits-all template for all organizations and NFP organizations will have their own suitability to some of the codes. The Governance codes analysed here include the OECD (2004), Sarbanes Oxley Act (2002), United Kingdoms' Combined Code (2003) and the Australian Securities Exchange Principles of 2007.

Table 1: Comparison of Governance Codes

<i>International / National Guidelines</i>	<i>NFP Applicability</i>
OECD	
Governance Framework	✓
Shareholders Rights	✗
Equitable Treatment of Shareholders	✗
Stakeholders	✓
Disclosure and Transparency	✓
SOX	
Public Company Oversight Board	✗
Auditor Independence	✗
Corporate Audit Responsibility	✗
Financial Disclosures	✓

NOT-FOR-PROFIT GOVERNANCE FOR INTERNATIONAL
CHARITIES - THE GOVERNANCE AND ACCOUNTABILITY GAP

Security Analyst Conflicts	✘
Corporate Fraud Accountability	✘
Penalties, Sentencing Guidelines	✘
CCUK	
Directors	✘
Remuneration	✘
Accountability and Audit	✔ ✘
Shareholder Relations	✘
ASXGCG	
Solid Foundations	✔
Board to Add Value	✘
Ethical Decision Making	✔
Integrity of Financial Reporting	✔
Timely and Balanced Disclosure	✔
Shareholders Rights	✘
Risk Management	✔
Enhanced Board Performance	✘
Remuneration	✘
Stakeholders	✔

Table 2 summarises the guidelines with potential application to NFPs from those listed in Table 1. It reveals a limited application of the guidelines in the NFP context, with the codes mainly advocating auditor

independence, board responsibilities, remuneration, and shareholders rights.

Table 2 Applicable Guidelines for NFP Governance

	OECD	SOX	CCUK	ASXGCG
Disclosure and Transparency	✔	✔	✔	✔
Stakeholders	✔	✘	✘	✔
Ethical Decision Making	✘	✘	✘	✔
Risk Management	✘	✘	✘	✔
Governance Framework	✔	✘	✘	✔

Disclosure & Transparency: Financial information can still be used by management as an indicator of the relative efficiency of the allocation of scarce resources, and to enable strategic decisions to be made. It also encourages further donations and grants by showing how money is allocated in supporting the NFP mission and vision. Disclosure and Transparency then is an important NFP Governance issue.

Stakeholder Interests: It has been argued that business is not just concerned with production of goods and services to profit shareholders, but has the welfare of a wider stakeholder class to consider. This appears to be particularly true for NFPs. Conti (2002 p.374), for example, states that a "stakeholder is a collective concept used to identify the interested parties in any organization". NFPs by nurturing their relationship with stakeholders can create mutual co-operation and efficiencies throughout the supply chain, again another significant NFP governance initiative.

Ethical Decision Making: Ethics has always been an important issue for even the early examples of the modern corporation (Smith, 1776 and Spencer, 1862). Directors specifically have been targeted by the ASXCGC (2003) to make sure they exhibit high ethical standards. In relation to NFPs, reputation is of paramount importance, as not only does it dictate the value of the business in terms of Goodwill (AASB1013, 1996) it also allows the business to forge relationships with customers and trading partners. For NFPs, it would appear that ethics and hence reputation is part and parcel of their existence, it is vital to create new customers, attract good employees, create good relationships with suppliers and goodwill with the community. Ethical conduct then is an essential NFP Governance principle.

Risk Management: Risk in terms of auditing can be

inherent, control or detection, but on a broader scale is seen as an indicator of the going concern or future viability of an organisation. Risks faced by NFPs include economic downturn, increases in interest and exchange rates, changes in legislation, employee turnover and industry challenges. Risk management for NFPs appears to be a critical management issue to be monitored and addressed on a regular basis. Risk Management is an important factor in terms of NFP Governance.

Corporate Governance Framework: Referring to the definitions presented of corporate governance, and its importance to the running and the future of organisations, it is important to acknowledge Owens' (2004) framework approach to corporate governance, of encompassing rules, regulations, systems and processes. It is reasonable to assume that those dealing with NFPs would prefer to do so with one that worked within an explicit a good governance framework, than with one that failed to do so. Thus the framework approach being all-inclusive should be particularly important to NFPs as it does not dictate specific obligations, but takes a general approach, which for NFPs will include the acknowledgement of the previous principles of stakeholders, risk management and ethics. This framework would also include a separation of roles of CEO and Chair, as well as the use of Independent Directors and a Diverse Board.

1.4 METHOD OF ENQUIRY

The review of the relevant literature has assisted in clarifying significant concepts and focusing the research questions. As only archival data is being analysed to collect information, the five areas of good corporate NFP governance were not all able to be analysed. Specifically annual reports were analysed for

their financial information (Accountability), and any information on Directors - Transparency (duality of roles, independence and equity). Information on Risk, Ethics and Stakeholders were not able to be analysed, as the data collection is limited only to annual reports. Data was collected using the archival case method (Scheele, 1967) to answer the following research questions:

Do International NFP entities exhibit NFP governance by

- 1) Using *independent directors* on their boards?
- 2) *Separating* the roles of CEO and chairperson?
- 3) Encouraging a *diverse* board?
- 4) Presenting *audited* financial information?

The charities were chosen by random sample of the 247 Wikipedia listing of international charity organizations. It is accepted that the selection of the research method for a study is critical, for it determines the appropriate information collection method within the research design (Aaker Kumar and Day 2004). According to Yin (1989) and McBurney (1994), the appropriate research method should be selected according to the specific circumstances of the research objectives, they identify five research methods being case study, experimental research, archival research, observational research and questionnaire research. The 247 International charities chosen, whilst not a fully representative sample, are a purposive or judgment non-probability based sample and were selected on the basis of being an appropriate registered charity for analysis (King 2004, Cavana, Delahaye and Sekaran 2001). The adopted methodology of sourcing archival data from publicly available sources was considered the most appropriate approach.

1.5 DATA ANALYSIS

1.5.1 Corporate Governance Framework

The listed international charities totaled 247, of which only 68 or 28% had an annual report listed on their website, thus 179 or 72% did NOT issue an annual report that was listed on their website. This is a significant gap in accountability on the part of the International NFP entities, as it not only discourages donors and government grants, but it also begs the question of who are they accountable to? This shows a distinct lack of corporate governance with 72% of the charities giving no Financial Information in terms of Accountability and Transparency.

Of the 247 International NFPs randomly selected via convenience sampling 11 or 16% of those with an annual report issued a corporate governance statement (or 4.45% of the total 247 NFP listed). According to listing rule 4.10 of the Australian Securities Exchange, only listed corporations are required to "comply or explain". The OECD introduced its voluntary initial corporate governance principles in 1999, and a revised version in 2004. Those principles were specifically aimed at the protection of investors, directly in corporations and indirectly through stock exchanges, universities, and charities, and were aimed at diverse countries and regions (OECD, 2004) to encourage economic growth and stability. They are non-binding and used to encourage and inculcate ethical behaviour and values in international market places. With this small disclosure of corporate governance by NFPs, the message of the importance of governance disclosure is still underwhelming in the NFP sector, which shows a significant gap in both financial and governance disclosures.

1.5.2 Independent Board Members (Research Question 1)

None of the NGPs listed whether or not their directors were independent. The definition of independence usually relates to material dealings or previous employment or share ownership (ASX, 2007). Being that directors usually play a voluntary role, the issue of independence may not be as significant in the NFP sector, however the literature still encourages the use of outside or independent Directors to create a more balanced board. It is suggested that NFP boards disclose if Directors are independent or not.

1.5.3 Duality of CEO and Chairperson (Research Question 2)

None of the NFP entities exhibited a duality of CEO/Chairperson role, showing they agree with the literature that the roles should be separated to enhance the workings of the board. The fact that no one person has ultimate control allows the board members to contribute equally and no balance of power remains. Further showing the role of the board chair is viewed as crucial and determinative of effectiveness (Hough 2006). NFP Boards should continue this practice as part of their NFP Governance initiatives.

1.5.4 Board Diversity (Research Question 3)

Of the 247 NFPs analysed, only 32 (just under 8%) listed the number of people on their board, with an average of just under 8 board members being the usual size of the board, which agrees with the research done by Brown (2007) - where it was suggested a board size of 8 was average. Of the NFPs that indicated the names of the board members, there was on average twice as many male board members as there was female members. NFP entities should continue to work on equity balances on boards.

1.5.5 Audited Financial Statements(Research

Question 4)

Only 10 NFPs or just over 4% were NOT audited, this is possibly due to the fact they were a smaller branch of a larger home organization, or that the audit report was not available as yet. Thus 237 or 96% presented audited financial statements. This is a great result as it does show that the NFP entities are being accountable in terms of their financial statements, a significant governance initiative.

1.6 CONCLUSIONS & RECOMMENDATIONS

NFPs need to be more transparent in relation to their governance initiatives, especially in relation to individual board members and their qualifications. Rosen (2005) stated that "maintaining and enhancing public trust is essential for organizations that want to raise money." It is recommended that NFP entities include in their annual reports a governance statement, which includes the following:

- 1/ Board of Directors information including qualifications and other directorships held.
- 2/ Specific detailing of the separation of the roles of chairman and CEO.
- 3/ Encouragement of the continuing need for board equity in terms of directors gender and qualifications.
- 4/ The continuing of audited financial statements in the annual report.
- 5/ The governance statement should also include brief information on risk management, ethics of the organization and information on the organizations stakeholders.

This research was limited to archival data via annual reports, thus it is suggested that for future research the three areas of corporate governance that are applicable to NFPs but was unable to be researched be targeted for

NOT-FOR-PROFIT GOVERNANCE FOR INTERNATIONAL
CHARITIES - THE GOVERNANCE AND ACCOUNTABILITY GAP

future research (ie ethics, risk management and stakeholder relations). Also as the majority of NFP entities were subject to audit, it is also suggested for future research that the notion of audit committees in a NFP context be further researched as well as other related governance areas.

The literature demonstrates that NFPs on an international basis are significant in terms of what they provide to communities, as well as their contribution to GDP and employment. Corporate Governance in the literature has also been shown to be an important part of business sustainability. As yet the NFP sector has not fully embraced corporate governance initiatives, and it is hoped that this research further encourages NFP entities to initiate a governance framework which includes detailing directors qualifications, the use of independent directors, a diverse board and the continuation of the separation of the CEO and Chairman roles. It is also hoped that NFPs continue to release audited financial statements to increase their accountability and transparency, as "the gap between public understanding and nonprofit reality is not sustainable" (Saxton, 2004), NFPs need to exhibit true NFP governance to bridge this gap and encourage future sustainability through grants and donations.

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